INDEPENDENT PRICING AND REGULATORY TRIBUNAL

BULK WATER MEDIUM TERM PRICE REVIEW

Tribunal Members

Dr Michael Keating AC - Chairman
Mr James Cox
Ms Cristina Cifuentes

Held at Portside Centre
Level 5, 207 Kent St, Sydney NSW 2000

On Friday, 25 November 2005, at 9.30am

WELCOME AND INTRODUCTION

THE CHAIRMAN: I would like to begin by welcoming you to this public hearing, which is being conducted by the Tribunal into bulk water prices. My name is Michael Keating and I am the Chairman of the Independent Pricing and Regulatory Tribunal, New South Wales. I would like to first of all introduce my fellow Tribunal members - Jim Cox, who is the Chief Executive of the Tribunal, on my right, and Cristina Cifuentes on my left.

The Tribunal is conducting this hearing under section 11 of its Act, and this hearing is part of a price review that will ultimately result in the Tribunal setting a medium-term price path for bulk water prices to be charged by the State Water Corporation and the Department of Natural Resources, starting from 1 July 2006.

Before commencing hearing from the key stakeholders, I would like to speak briefly about the review process. I understand that the current timetable is available on the table outside this room. The Tribunal recognises that there have been a number of changes to the timetable for the review. The Tribunal decided that we would like to have a public hearing in Sydney, which is what we're having today, and that's shortly after the closing of submissions. In fact, I think there might still be submissions coming in, even though the due date for submissions has effectively finished.

The Tribunal has also decided that it will hold workshops in regional centres in the latter half of January, and that will involve us going to Moree, Griffith and Dubbo. At these workshops we expect to discuss a number of specific issues relating to this review of bulk water, and we will be making our consultants' analysis of capital and operating expenditure available for those workshops.

The Tribunal's general approach to price setting and the matters its Act says that it must take into account in conducting an investigation that these matters were previously set out in the issues paper that the Tribunal released as far back as September 2004. As I am sure most of you are aware, in August this year we released, in effect, an interim price determination for the current financial year, 2005-2006.

In the report that accompanied that interim determination the Tribunal outlined some of the matters the Tribunal considered important to this longer-term price path review. The Tribunal also indicated that it expected State Water and the Department of Natural Resources to make their submissions available by 30 September. I think that was met. Interested parties were able to make submissions up until 18 November. Some of them seem to have extended that up to today.

The State Water and DNR submissions are available on the IPART web site, as are in fact all of the other submissions that have been made to this review so far. We are grateful for the large number of submissions that have been made to the review. Some of the organisations that have made submissions to the review will be presenting a case to the hearing today, and you can be assured that all of the submissions will be carefully considered by the Tribunal in developing its findings and recommendations.

The Tribunal has been involved in setting bulk water prices since 1996-97, and one of the Tribunal's key objectives for price reform over this time has been to set charges to progressively increase the level of cost recovery. That is consistent with the objectives agreed by the Council of Australian Governments, firstly in 1994, but, at the same time, we do need to take into account the impact on customers. The Tribunal has also restructured prices to improve cost revenue activity and improve conservation signals to users.

The Tribunal last held a major review into prices for bulk water services in 2001, when the former Department of Land and Water Conservation was responsible for providing these services. Since then that department has been restructured and the functions related to river water and storage operations on regulated matters are now performed by the State Water Corporation, a newly corporatised entity. The functions relating to water resource management are performed by the newly formed Department of Natural Resources, and the newly established Catchment Management Authorities also have a role in water resource management.

Another significant change since the major review in 2001 has been the introduction of the National Water

Initiative, which essentially, as I see it, refreshes the 1994 agreement by the Council of Australian Governments and provides guidance for, amongst other things, water pricing reform throughout Australia. The National Water Initiative, as you probably know, was signed by the New South Wales Government, along with other governments, in June 2004.

The task before the Tribunal now is to actually set prices for bulk water extraction from regulated rivers, unregulated rivers and ground water. In doing so, we will need to take account of a wide range of matters, as are set out in our Act, and these include, but are not limited to, the impact of prices on the financial viability of the regulated agencies on the one hand and, if you like, on the other hand, the potential impact of prices on customers.

This hearing is a very important stage in the broader price review process. It provides an opportunity for the Tribunal to hear in a public forum from the water businesses and other key stakeholders and for the Tribunal, and its secretariat in particular, to question some of the propositions that are being advanced.

Before we commence the proceedings today, I would like to say a few words about the process of this hearing. I think you all have available to you a timetable, which indicates the order for presenters. The proceedings today are being recorded and the transcript will be available on the IPART web site I hope early next week. Each organisation appearing has an allotted presentation time, and this will be followed by a period for questions. I would ask all presenters to stick to the allotted time. In fact, I will try to give you a warning three minutes before your time runs out if I can catch your eye.

The questions from the presenters will be asked by the Tribunal secretariat and by members of the Tribunal, but we have allowed, in addition, 30 minutes at the end of this morning's proceedings for other people present today to express their views on issues relating to the determination or to pose questions for State Water and the Department of Natural Resources. We will be calling on those two agencies to respond again in the afternoon session.

At the table at the front of the room are the two secretariat members who will be asking the questions.

Colin Reid is nearest to me, who is the Director of Water Programs, and Michael Seery, who is on the right of Colin, is the Program Manager for Bulk Water Pricing in IPART.

This, of course, is only one stage, and we do anticipate that the Tribunal will provide further opportunities for consultation with interested parties through the course of this price review and, as I mentioned earlier, in January there will be three meetings in those regional centres.

STATE WATER CORPORATION

THE CHAIRMAN: We will start now with the State Water Corporation's presentation, followed by the Department of Natural Resources. I therefore would like to call the Chairman of the State Water Corporation and, following that, Mr Abel Immaraj, the Chief Executive Officer, to make the initial presentation. Would you mind introducing your colleagues at the table for the benefit of the transcribers?

MR WRIGHT: Good morning, everyone. My name is Tony Wright, I am Chairman of the State Water Corporation, and I'd like to introduce Abel Immaraj on my left, who is the Chief Executive of State Water, and Russell Simons on his left, who is the Chief Financial Officer.

My purpose is just to open the presentation by State Water Corporation. I want to set the scene and outline the main points of our proposal. Our Chief Executive and Managing Director, Abel Immaraj, will provide the detailed rationale.

As Dr Keating has observed, this bulk water pricing review comes at a time of great reform in both pricing and management across Australia in the water industry. These reforms respond to broad imperatives to tackle industry efficiency improvements, water demands that have outstripped supply, the compounding effect of climate change as well. It's true that good progress is being made in reforming the institutional arrangements and management practices across Australia. However, price levels and pricing arrangements at this stage of the reform differ widely between the states, as they do across New South Wales regions.

The national and state reform agenda has been quite explicit in shaping the principles on which our submission is based. Three main reform drivers have shaped our submission. The first is the National Water Initiative, which carries formal agreement by New South Wales. As you know, this agreement to NWI includes full cost recovery.

Our response to this undertaking is a clear proposal to extinguish the current operating subsidy over a five-year period. No one-year price hike is proposed or contemplated. This will, of course, progressively

eliminate the substantial inter-valley cross-subsidies that exist now across New South Wales, and it will make transparent the level of subsidy as required by the NWI agreement. Moreover, the five-year phase-in is entirely in keeping with IPART's glide-path concept to mitigate price reforms and price reform impacts. It is worth noting also that our proposal recognises the ongoing relevance of a government share of the water tariff.

The second reform driver relates to the way the COAG strategic framework has implications for the tariff structure. The requirement to provide a conservation price signal has already been played out. It is really a condition of State Water's initial operating licence. Our licence explicitly requires a rapid change from a 30 per cent usage base structure to a 60 per cent usage base structure. Our pricing proposal faithfully adheres to this licence condition, but Abel will outline the implications of this change.

The third reform driver that I want to talk about is a further issue of cross-subsidy and of equity, the ratio between high security and general security water charges. We propose that the price margin between these two entitlement schemes should be based on a rational foundation, one that reflects the forgone revenue opportunity of storing and withholding high-security water. The proposal also happens to more truly represent the relative value margin between these two types of entitlement.

These are the main issues addressed in our pricing proposal. I will now pass to our CEO, Abel Immaraj, to continue the presentation.

MR IMMARAJ: Mr Chairman, members of the Tribunal, ladies and gentlemen, our pricing proposal dated September 2005 is what I will be addressing today. The presentation overview covers a brief background to State Water Corporation itself, highlighting some of the changes that have recently occurred, the business drivers and the strategy that State Water has responded to the operating environment, details of the cost recovery and the pricing proposals.

As I present, we will be covering some of these issues which have been raised both with us as well as in submissions received by IPART: are these efficient costs;

why charge access licensees only; why a regulatory asset-based approach; why a return on assets, and why 7 per cent; why change the fixed and variable ratio from the current to what's being proposed; why reduce the average usage volume in calculating the usage price; why charge a premium for high-security access licences; why remove subsidies; and what are these unconstrained prices that are being reflected in the submission? So along the presentation I will try to cover these.

First up, an introduction to State Water. This is the area of operations for State Water - the whole of the state except the Sydney metropolitan area and the ACT, and parts of the unregulated rivers. What do we do? We provide customer services, and that's just one customer service officer, and that diagram depicts the number of people that each customer service officer has to deal with, not across the whole state but in a particular area of his operations. That customer service officer services, on average, over 250 people.

What do we mean by providing services at a customer service level? Each customer service officer has to manage all the metering associated with roughly a million hectares of land and each month undertake an extensive calculation of what the total usage or extraction has been. Also, every time there is a supplementary event or a storm event in the catchment which triggers off a supplementary access event, we have to cover the same terrain, calculate the usage. We have roughly 10,000 metered works to monitor each month across the state. We process and manage water orders, because our system operates on an order-based system. We provide advice and ensure compliance with the ordering.

The major value added is the protection of the confirmed water in transit for customers, so what we do is prevent the wrong people from taking water at the wrong time. As somebody said, it is to keep all the other users honest. Our customers have indicated that it is not adequate to deal with overusage after the event. It is too late, the water cannot be retrieved. We have 45 of these customer service officers across the state.

What else do we do? We run the rivers. On a daily basis we have 34 river operation staff based at various locations across the state, and their job is to regulate

the flow in 11 systems across the state. That is about 11,000km of rivers across the state. Every day and each day, 24/7, the rivers are regulated, and the purpose of river operations is to make sure that the water is there at the right time at the right price. We assess the information, we analyse it and we make a critical decision on how much water should be mobilised in the system at any point of time, exactly where the customers want it and exactly where the environment needs it.

Due to the travel times and weather imperatives, we take some of the risk involved in supply management and the occasional demand management. Annually we deliver about 5,000 gigalitres of water, ranging from a low of 3,000 gigalitres, which has been the recent experience, up to a maximum of 5,500 gigalitres. We also maintain a flood operations capability across the state. The five gated dams require us to manage floods and rapid floods through the structure.

We have intensive data and information systems, water auditing and usage data bases, computer-aided operations for rivers and flow regulation systems. Our objective is to maximise the delivery of water allocated to the customers for that year and to ensure that the minimum flow requirements for the environmental targets are met. We also make sure that basic rights are protected along the way.

The third thing we do is asset management. We have 156 asset management staff across the state. We maintain and manage and operate 20 dams, 240 weirs and regulators across the state, over 90,000 hectares of land associated with the storages, and the total asset value is $2.3 billion. We operate and maintain each day and every day the operational maintenance requirements for those structures, major periodic maintenance, surveillance, land management. We also manage the upgrades of those structures to make sure they meet all compliance requirements. We manage all the projects and procurement associated with each of those projects, and we also now more recently are responsible for protection of those critical infrastructures. Our objective here is to provide assets fit for purpose, to maintain and operate them to agreed standards and performance measures.

We also have 50 corporate services staff spread across the state, the bulk of them in Dubbo. We provide human resource and industrial relations support to all staff, payroll services for 285 staff at 42 different locations in the state, all the procurement and purchasing, finance and accounts, billing and debt management for 6,500 customers as well as 22,000 other customers in ground water and unregulated rivers, risk management services, audit and compliance, legal services, information management and technology, and business administration associated with running this business.

We are responsible also for ensuring regulatory compliance with our own legislation as well as with the Water Management Act 2000 requirements and the Water Act 1912. Our objective here is to be efficient and effective in our corporation to develop and grow the business.

What does our corporate governance structure look like? We have two shareholders, the treasurer and the assistant treasurer. We have a board of directors, chaired by Tony Wright. We have six other directors. The corporation itself has an operating licence issued by the portfolio minister reflecting all the regulatory requirements to protect consumers and to protect the assets. That operating licence is a key driver for the business.

We have works approvals for all our structures to be issued by the Department of Natural Resources, and that too specifies the operating requirements for those structures. To help operate in a cooperative fashion, there are memoranda of understanding, as stipulated in our Act and in our operating licence. So we have MOUs with the Department of Environment and Conservation, the Department of Primary Industry and the Department of Natural Resources to help us work in a cooperative fashion.

Our pricing is regulated through IPART, but our operating licence is also operated through IPART. Our services are provided to customers primarily, the 6,500 customers. We also provide services to the community in protecting their basic rights and making sure that stock and domestic water is available. We also provide water for the environment in accordance with the water sharing plans.

Our customers are created when they are issued with an access licence and that access licence is issued by the

resource regulator, the Department of Natural Resources, and the way the rivers have to be managed or regulated is specified in the water sharing plans.

This slide gives you a depiction of the regulatory framework for State Water - just when you thought life was getting less complex! This shows the amount of regulation that impinges on State Water's role, and it is not difficult to imagine why. Water is a shared resource and there are a lot of competing demands for it. To protect a lot of those competing interests, there is quite a lot of regulation, and this is not too different from what happens in a lot of the other states in Australia.

We have the shareholders, the portfolio minister, the Department of Natural Resources, DEC - the Department of Environment and Conservation - the Dams Safety Committee, who set the standards for the safety of our large dams. we have government asset management committee requirements, which stipulate how the assets owned by the government should be maintained and managed; the pricing regulation and also the direct regulation of the customers access by DNR. Our role in response to each of those regulations is also outlined.

In particular if you examine the Department of Natural Resources and State Water Corporation interface, there are eight different levels at which we interface with DNR on a regular basis.

We are not at liberty to do what we like with the water that we manage. The water in the storages is not owned by State Water. As soon as it is committed through an available water determination, it belongs to the customers. All we do is make sure that the customers get the water when it is required. So, again in response to that complex regulatory environment, State Water has had to set up all its systems and develop its work programs and activities to make sure we meet the compliance needs.

I will skip through the next slide. The effective separation of DNR and State Water occurs when we can draw a line between having made the regulatory decisions, State Water is then at liberty to deliver those products both to the environment as well as to our customers. We are not responsible for creating the access rights. We are not responsible for assigning the rights between consumptive users and the environment, nor amongst consumptive users; our purpose is to deliver the rights in a sustainable manner. So we operate the systems and we manage the assets to deliver those rights. Physically, the right of water is realised when people use the water and notionally when they trade in water. So we allow for the transfers of water to occur and for people to realise the rights.

Our business drivers, which lead to where our costs come from, fall largely into these three categories: first, regulatory environment for a state-owned corporation being the acts, the regulations and policy frameworks that drive State Water; second, the operating environment which is largely driven by the operating licence and its specifications, the water sharing plan and the works approvals for each of our structures, and the performance indicators and measures specified in the operating licence as well as in the works approval.

The third category is the service delivery environment which involves engagement with the customers through a customer service charter, the rights and obligations of each party in the charter, the memoranda of understanding, and also, more recently, complaints and dispute systems that we are now compelled to have, and a community consultation process in the way State Water delivers its services. So those are the key business drivers.

The planning process that we have adopted is really simple. What are we solely accountable for as a core business; and where do these drivers result in a shared accountability, not just for State Water but something that is shared with another agency or with another group; and where does State Water assume accountability where it is not specified in each of these regulatory drivers?

We have identified what falls into the sole accountability of core business. One example of that is where we have the sole accountability for the ownership of the assets and, therefore, for the maintenance and management of those assets. So we need to maintain and renew those assets because it is our sole accountability.

A shared accountability could be read as a joint proposal for mitigating the impacts of cold water pollution downstream of dams. So that project is treated slightly differently.

Finally, where we have assumed accountability, we are compelled to justify to the investors that there is a return on that investment. Without that, the assumed accountability does not need to result in any expenditure.

Our planning process, having identified the business drivers and the specifications, is to set clear objectives for planning. We have developed a new program structure since the last determination. We have adopted a risk management approach in ascertaining what we invest money in, and we have developed a service delivery strategy that tells us what is the best way of achieving the outcome - do we do it in-house, do we go for a competitive tender or do we have an alliance or a partnership approach?

In another pictorial fashion, what this slide translates to is, having identified the mandate and the business drivers, we go through a process of planning. Then we go through a process of resourcing the plans and we implement those plans or deliver the services.

The key drivers that fall into those groups are: regulatory operating and service delivery. The planning is largely the development of a corporate plan, but also the programs that underpin that corporate plan. The corporate plan also has standards that are developed from the drivers and there are also performance measures that we must undertake.

It is at that point that we need to bring two things - prudent expenditure and efficient - expenditure into being. Prudent expenditure is when we must do something because there is a clear driver for it. If there is anything in our submission that does not have a driver, then it should not be there for cost recovery.

The second thing is efficiency, how far do you go in investing money into that activity? A lot of that is driven by performance measures. If there is a requirement for us to maintain a surveillance regime on dams and that entails two visits a week or one visit a week, then that is a performance measure. We must spend enough money to make sure we meet that requirement. That has been a key dominant driver in setting our corporate plan.

Having said that, at the resourcing level, we take a lot of the practical issue of delivering those objectives, and we do that by allocating resources, both into operating as well as capital, and deliver our services through a works program which is largely capital, and an operating program which is largely operating expenditure. Once the services have been delivered, we have a review process each year to ensure whether we are actually delivering those services and whether or not we are efficient in doing that.

The business specifications, as I mentioned, come largely from the operating licence, but they also come from our statement of corporate intent which is the contract signed between the organisation and the shareholders. The statement of corporate intent fits in under a state-owned corporations framework and the commercial policy framework of government.

The State Water Corporation corporate plan identifies seven critical areas for State Water's success. Each of those seven critical areas focuses on those drivers: what are the drivers driving the business and how will we know at the end of each year whether we have actually met the requirements of those drivers and whether we have been successful?

The performance measures to measure success have also been outlined in our corporate plan. Resulting from that we have a new program structure that helps us to structure our work and activities to meet those requirements. As required by the operating licence, we have developed a customer service charter in consultation with our customers. The customer service charter specifies: what are the things that the customers see as value for money? What are the levels of service required by the customers; And what sort of frequency or measures will the customers use to just our performance of services to them?

To enable these issues to be quantified, we have embarked on a valley business planning process. So for each valley not only do we specify the levels of service but we also specify to each of the customers that this is the input or the cost required to meet those levels of service. We have embarked on that process, and in the next three to four months, we will be finalising the valley business plans in consultation with customers. There will be some negotiation on areas where there is discretion, but where there is a mandate through a regulatory process, the

customers will have to accept those costs.

In an overview of the submission itself we will be covering: the building block approach; a brief discussion on our financial viability; what are the efficient full costs for State Water; how we propose that those costs be shared; and pricing and other issues. Every one of these five items is placed in front of the Tribunal for its consideration. The decision of the Tribunal is final.

The approach to pricing largely in our submission has a revenue for operating expenditure and a revenue for capital investment. The revenue for capital investment is driven by this concept of regulatory asset base, and that regulatory asset base is the base on which prices are determined.

We have also shown in our submission the total capital expenditure program for the next five years, and the third thing that goes into calculating the revenue for a capital investment is the weighted average cost of capital. So the revenue for operating expenditure plus the revenue for capital investment results in our total requirement for State Water. That has been put into the submission for consideration by IPART, and we have also shown where the drivers for our operating and capital expenditure come from. IPART will consider those and set the maximum price. That is broadly the process, and I must acknowledge Richard Warner's paper in the Australian Water Association newsletter.

The three prices that are set by IPART are: high security fixed charge in terms of a dollar per megalitre of entitlement; a general security fixed charge also at a dollar per megalitre of entitlement; and a third component is the variable charges at a dollar per megalitre of actual usage. Whether you are a high security licence holder or a general security licence holder, every megalitre of consumption is charged at that variable rate.

The building block approach is consistent with the New South Wales commercial policy framework. It is consistent with what the other states have adopted, and it is consistent with what all the other state-owned corporations - particularly for bulk water or metro water - have adopted in New South Wales.

What we have done is assessed on the 1 July 2004 date, which is the start or the corporatisation date for State Water, a regulatory asset base of $302m. It is commensurate with the past annuity set by IPART in its previous determination of $18m. That $18m annuity was shared by government and customers. We have, therefore, apportioned that regulatory asset base at $302m back on to two regulatory asset bases - one for the customers and one for the government.

So this is where the concept of the government as a customer has been introduced. State Water has roughly 6,300 customers, and we have another customer called the government. The government has a regulatory asset base on which we are seeking the same cost implications.

We also checked to see whether that $302m came in on line with the discounted cash flows of existing prices, and it came in roughly at about the same - $305m. So the apportionment of the users, the government shares of the regulatory asset base, on 1 July 2004, are roughly $101m of the asset base to customers and $192m to government. We have also broken that down into each valley, which I will show a bit later.

Having done that on 1 July 2004, we had to update the RAB. Once again that is something that IPART will consider because it is in not the discretion of State Water to capitalise things; only what is prudent and efficient is capitalised onto the regulatory asset base, and that is a decision or a determination of the Tribunal.

So we started with the $302 regulatory asset base. We added the notional regulatory asset base for the Murray Darling Basin Commission as well as the Dumaresq Barwon Border Rivers Commission, and that brought the total up to $406m as of 1 July 2004. We also assumed ownership of the Fish River water supply scheme on 2 January 2005, and the RAB for that was $46.5m. We have demonstrated in the submission what we see as prudent and efficient capital expenditure. Less depreciation disposal and allowing for pro rata inflation for 2004/2005 and 2005/2006, that brought the 1 July 2005 regulatory asset base to $531.4m. This was apportioned back to the same regulatory asset basis for the users and the customers in accordance with the nature of that expenditure for that 12 months. So we apportioned it with $275.6m for the users and $255.8m for

the government. Future splits of the capitalisation will occur on the basis of what was that capital incurred for.

Breaking it down into each of the valleys, on 1 July 2004, the splits between government and users for each of the valleys is shown on this slide. One that I must point out is the Murray, which is largely due to the notional regulatory asset base for the Murray Darling Basin Commission assets which are attributed to New South Wales.

In talking about commercial viability or financial viability of State Water, not only is the regulatory asset base important to be consistent with the state-owned corporations' requirements or the commercial policy framework, but it is also more efficient for us to adopt the same approach in the pricing determination process, and there precedent has been set for the metropolitan water utilities. What you will see on this slide are the two graphs - one showing the annuity approach and what happens to the profitability of State Water, and the other showing what happens if you use the regulatory asset base and roll-forward approach.

With the annuity approach, by 2012-2013, the business is not able to service its debt; whereas using the regulatory asset base and roll-forward approach we remain profitable. So it is an important distinction for a commercial business and it is one of the sustainability factors under the commercial policy framework. We have provided further details on what this does for the credit rating and perhaps the borrowing costs for State Water if we were to become non-profitable.

Next is full cost recovery. There are only two elements to the cost that we are seeking to recover from users - the first is the operating cost and the second is a category that we have called commercial costs, which includes two components; namely, a return on assets, and a return of assets, which is equivalent to depreciation.

The efficient costs in the area of operating of capital fall into these categories of: asset management; water delivery operations; customer services; corporate services; and the commercial costs, which have been identified in the submission as a rate of return on capital at 7 per cent weighted average cost of capital.

The full costs also shown in the submission show the five-year projections above the capital expenditure as well as the operating expenditure and in accordance with the board direction, we have set some efficiency targets in our operating expenditure in the last three years.

Our full costs broken down graphically look like this: we have roughly $17.5m of employment costs and $28m worth of operating and maintenance costs. The smaller contribution of operating and maintenance from the government is largely for the Murray Darling Basin under the agreement, and the rest is on return on assets and depreciation.

In the pie chart for the 2006-2007 costs, the breakdown is roughly 75 per cent of 2006-2007 total cost recovery from customers and, 25 per cent of contribution to the government.

Just as a quick comparison, the reason we have operating expenditure is largely driven by our assets. We have $2.3 billion worth of an asset base that we must maintain. We spend roughly $47m in operating those assets and maintaining them. The opening regulatory industry asset base of 2006, which is the starting date for the pricing, is $531m. The total return which includes both return on assets and the return off assets is $43m.

The customer regulatory asset base share of that $531m is $276m, and the customer return that we are seeking out of 7 per cent is $22m. It puts it in perspective in terms of what are the costs of running this big asset base. There are some specific to valleys, but I will skip that due to lack of time.

We have proposed some user shares here also for IPART's consideration. The only change is the environmental enhancement where consistent with the service enhancement costs being apportioned 100 per cent to users, the environmental enhancement share is proposed to be zero per cent to users and 100 per cent to government.

These pricing issues have been discussed at length in the submission, but the main point I'd make is that our costs are mainly fixed. The only reason we are making the move from fixed 70 per cent down to 40 per cent is that it is a requirement of the operating licence. However, the

corporation is happy to meet that challenge, provided the pricing can support that range of variation in revenue.

The proposal is to reduce it to 50 per cent in years one and two, and then down to 40 per cent of fixed in year three. We propose the same ratio in each valley, but that is open to debate, whether it should be variable in each valley.

The less than average will probably elicit a lot of debate as to whether it should be different for each valley or it should be the same across the states. We have assumed that it should be the same across the states and that is what we have proposed, the main driver being the change to the fixed revenue. Currently across the states 70 percent of our revenue comes from fixed charges. We do not have to sell a single megalitre of water this year, and we will still recover 70 per cent of the revenue because it is all fixed. What we have to do now is move, in year three, down to 40 per cent of our revenues through fixed, and that is a big impact on the business. So we've proposed this less than average usage to be the basis for calculating the usage price. That reduces the risk considerably to State Water.

Pictorially, what it does is when you move from 12 per cent of the variable charge up to a 60 per cent variable charge - in two of the largest valleys in the state at the moment the variable charge is currently sitting at 12 per cent of the total revenue - as you can see, the variability of revenue is tremendous. Also, the water sharing plan limits do not allow us to recover when the allocation exceeds the planned limit. Or in reality, it could exceed that planned limit, so we are really constrained to living within a smaller variation.

With the high general security premiums, we are proposing that the current ratio of high security to general security price be amended to reflect the high security reliability in each of those valleys and the fact that we store roughly two years of supplies in each valley in each dam.

This is probably only relevant to one valley at the moment, the removal of wholesale discounts, so I'll skip over that.

The unconstrained prices - what we have shown there is the maximum prices that would be derived if the full cost recovery was achieved in one year; in other words, in one time step. That is the worst case scenario that could be envisaged. We have deliberately put that out there to elicit response. We have proposed in the submission a progressive increase over five years. We have also proposed in our submission that those unconstrained prices could be capped in several ways. There are three or four different ways we could do that. Just in case there's a strong bias towards over-recovery, we have also suggested in the submission that the prices can be adjusted at the end of that period to avoid that over-recovery or under-recovery for us.

To close, we have done a quick analysis of what the current prices or the most recent prices in Queensland, Victoria and NSW are. 2003 prices, assuming a 1000ML general security licence - I must make a point here that it is not easy to define the relativity of general security across the states, but say we could adopt that - with a full 1000ML usage in that year, across Queensland you would have had a bill of $9,910 to $24,900 in various valleys; in the Murray part of Victoria in 2004 the bill would have been $7,850 to $11,120; the rest of Victoria $12,470 to $15,000; in NSW in 2005, the lowest is $3,930 and the most you would pay for that sort of licence is $13,400.

What we are proposing is that by 2010 in the NSW Murray we should go up to $9,536 and the rest of NSW should go up from $4,558 to $24,000. We have excluded the small retail schemes across each of those states. We have also removed the small subsidised schemes, so in NSW this does not reflect the Peel Valley or the coastal valleys. There is a significant increase in those valleys which we do acknowledge and there will have to be new solutions found to keep those valleys alive. Thank you very much.

MR SEERY: One of the concerns that the Tribunal has, or the Secretariat has, relates to the allocation of costs by valley. I know that we have obtained additional information from yourselves recently on a valley-by-valley basis, but my question is what assurances can State Water make on the robustness of this valley-by-valley data, both in the capital and in the operating expenditure sense, and also when you look at the asset values that you can attribute to each valley - what assurances do we have that those numbers are the right numbers?

MR IMMARAJ: I will address the valley-by-valley aspect in the first instance. We have provided that information on a valley-by-valley basis. As to the asset values, as you may recall from the previous determination, we did an engineering equivalent replacement value assessment on each of those structures in each valley some years ago. The regulatory asset base is largely based on what the potential earning of each of those assets is, and the return on that regulatory asset base is also therefore driven by that RAB assessment, so those numbers are fairly consistent and robust.

The capex forecast, however, is based on current analysis of the situation and what we need to spend to make those structures either compliant or to improve their reliability or to improve their serviceability. So those capex forecasts are as accurate as we can get them at this time.

What the operating expenditure talks about is our costs of operating those systems to current levels of service. So the operating expenditure is robust to meet those requirements. If the levels of service were to change for any reason, then those operating expenditures will either move up or down depending on where the service levels were. How would you envisage the robustness of costs unless you look at the inputs as well as the levels of service that those inputs provide?

MR SEERY: Under the previous determination, State Water has had an annuity approach, and the Tribunal is wondering whether that approach would continue into the future or whether we can move to what you are asking for, a RAB approach. I guess one question that has been raised is the reconciliation of the revenue you have obtained under the RAB approach. How do you reconcile what you've received from users with the money you have expended on capital expenditure over time; have you done a reconciliation of that and, if so, how has that come out?

MR IMMARAJ: We have done a reconciliation of that. I will ask Russell to explain briefly the information that we have, and then ask whether you would be interested in receiving that.

MR SIMONS: We have done a reconciliation to look at the expenditure that was undertaken over the previous years and to discount back the figures that we came up with for that over-expenditure that may have occurred, and it comes out at roughly the same figures. We would be happy to supply that to you.

MR SEERY: That would be good, thank you.

MR REID: One of the issues that has been raised in the NSW Irrigators Council submission is the question of the efficiency of State Water's costs, and to the extent to which those services are made contestable. I note that your operating costs, which in 2004-2005 were around $26m, are forecast to rise to $45m or greater in 2006-2007, with your full time staff members rising from about 250 to over 300. First, could you give us an explanation for that significant increase in operating costs between those years and, two, to what extent are the services undertaken in-house, if you like, within State Water, and the extent to which you do any market testing.

MR IMMARAJ: There seems to be a little confusion in some submission with regard to hydrometric costs. It is not a choice for us in terms of whether we can procure those hydrometric services through a competitive source. At the moment we are seeking to get those services from the Department of Natural Resources who runs the infrastructure and the network.

There was another point made with regard to metering, whether that should be contestable and whether it should be outsourced. As I have tried to demonstrate through the presentation, some of these operational issues are not clearly understood. Metering is just one part of managing the water order and the regulation of that flow to customers.

Protection of that water that is in transit is ultimately most important to customers. In discussions with customers on the levels of service, two points were made. One, once the confirmed order is in transit, the customer wants assurance that that water is protected from use by others. The second part was that the people still prefer to deal with a customer service officer who has knowledge of the customer rather than an interactive voice response based or a telephone based system. So there have

been quite a few things that went into creating the manning requirements or the resourcing requirements.

Second, when there are performance targets that we must meet and there are levels of risk that are associated with not being able to meet those targets, then they are the sort of risks that the state cannot accept. In our submission, all our costs down to the product level have been identified, and they have been clearly linked to those specific drivers, including performance measures. So why must we have two people doing this job as against one person?

If you could operate the rivers only on the weekdays and not on the weekends or on public holidays, would that make a difference in cost efficiency? Could we set the flow levels to a certain setting on Friday and not worry about it until Monday? They are the sorts of discussions that have been accepted. The dam safety committee, will it accept a reduced level of service and therefore reduced costs? So to talk about efficiency without understanding the drivers or the levels of service that are required by the user is meaningless.

MR WRIGHT: The $26m quoted excludes the Murray Darling operations, and the $45m quoted actually includes Murray Darling. It is not a correct comparison.

MR SIMONS: State Water itself has moved from $26m to $33m.

MR REID: That is still obviously a fairly significant increase; could you explain that variation?

MR SIMONS: We are in the process of putting that together for you.

MR WRIGHT: State Water, unlike many other corporatised entities in NSW, comes out of a departmental structure. Sydney Water, for instance, was a statutory authority for 100 years before it was corporatised, so it had its own systems and operating procedures worked out as a stand-alone entity. State Water has not had that 100 years to do that sort of thing, and we are in the process of developing many commercial systems that were previously intertwined in a departmental structure. Some of those activities now have to be stand-alone, although many of them are still intertwined. As Abel Immaraj said, we don't run hydrometrics, Natural Resources runs that, so we don't have the choice about sourcing hydrometrics. There are many things that we don't have choices about. As far as utilities go, there is very little left in-house in this organisation compared with others.

MR IMMARAJ: As of this last 12 months another important change that has occurred is the issuing of the new access licences. The access licence is held by our customer, so our customer is the person who holds the access licence, but the person who places the water order on any given day and the person who we interact on any given day for water delivery purposes is the person who holds the works approval which is linked to an access licence.

In 30 per cent of the cases, that access licence holder and the works approval holder are different people with different places of residence. The works approval holder is the person who has the metered works. But there is a third party, which is the "bill to" party, who we have to deal with for billing purposes. So this complexity is fairly significant. To develop the systems to deal with this efficiently and to keep track of all the changes in the licensing and balances from previous years, there are significant costs involved in that. We have spent a lot of effort making sure that all the services can continue and yet our business can continue to receive its revenue.

THE CHAIRMAN: Can I ask a follow-up question. The comparable basis operations have gone from $33m to $45m; is that not right?

MR WRIGHT: No, it is $26m to $33m.

THE CHAIRMAN: So it is projected to go from $33 on a comparable basis to $45m. What is the increased proposed?

MR REID: As far as State Water's own costs are concerned, we are talking about $26m to $33m.

THE CHAIRMAN: In the last two years?

MR REID: Yes.

THE CHAIRMAN: In the last two years $26m to $33m. What you are then saying is that the services have gone up

commensurate with that?

MR IMMARAJ: The complexity of services has gone up considerably. The regulatory framework as it has evolved with the operating licences as well has become a lot clearer. There is quite a lot of complexity that didn't exist two years ago, or was handled by other parts of the larger Department of Land and Water Conservation.

MR REID: State Water undertakes a number of activities on behalf of the Department of Natural Resources. If you would let me know what service agreements exist between DNR and State Water, and how can we be assured that the costs of these are based in the prices being proposed by State Water and by DNR?

MR IMMARAJ: That is one area that we are still yet to have confirmed service agreements in place. We have service agreements for physical services such as offices and buildings that we currently occupy where we pay rental to the Department of Natural Resources which might be the primary tenant, so those are certain. However, we do undertake services such as ground water metering and billing, and unregulated billing, and we don't have a firm service agreement signed by both parties to that. We have costs that we incur. We are in the process of negotiating a final service agreement. Similarly hydrometric services, we have exchanged documents. However, we don't have a signature on the bottom. We both know what the costs are and we are assured by DNR that those costs are not included in their submission.

MR SIMONS: From our perspective the billing metering costs of ground water and unreg have definitely been excluded from our submission.

MR REID: In a number of submissions there has been a fair bit of play on the national water initiative. Out of that initiative what new activities or functions or costs have been imposed on State Water and what has been the impact of those on your costs?

MR IMMARAJ: It has been largely a driver for the way that the costs recovery principles are applied in the submission. So we have taken the National Water Initiative drivers which are now part of NSW requirements. In the pursuing of the upper bound pricing we have adopted a regulatory asset base approach, and we've said if the NWI requires water utilities across Australia to adopt an upper bound pricing, we would seek a rate of return on the regulatory asset base apportioned to customers and from the government a regulatory asset base return on the government. So we have largely taken it from that perspective.

However, the National Water Initiative also triggers off a series of things that we have identified as potential opportunities and risks to the organisation. We are not quite sure what that play will be in terms of what are relative to our customers and eventually on our revenue. That is yet uncertain, and what efficiency savings or measures that might be put in place for water for the environment and whether those costs will be recoverable from a third customer called the environment perhaps. Those things are still uncertain.

MR COX: In view of the time, I might content myself with just one question. There are a lot of questions I would love to ask you. One of the interesting things about this inquiry, as I understand it, is that most of the prices accept that pricing should be on the basis of full cost recovery. In that context, I guess my question to you is what did you do to assure yourselves that the costs proposed in your submission are in fact the efficient costs of undertaking the activities?

MR IMMARAJ: We have done a couple of things. First of all, we have tried to benchmark ourselves against other large bulk water type of utilities. We have also had another good look at the drivers for the business and tried to make sure that our interpretation of those drivers and its application to State Water was relevant. So in the first bit, which was the benchmarking against our equivalent businesses in Queensland - namely, SunWater and Goulburn Murray Water in Victoria - have yielded us a level of comfort in our costs, both in terms of the direct costs as well as overheads.

We have also looked at costs of large bulk water suppliers, such as Sydney Catchment Authority, and we have a level of comfort there too that our costs are reasonable in terms of what has been previously accepted. So, on that count, we have convinced ourselves that our costs are efficient.

In the final wash-up we have indicated that the last three years we would achieve some savings, largely through improved technology that we will be implementing within State Water, so the three years, from 2008 onwards, we have foreshadowed that there will be an efficiency measure put in place.

MR COX: If you are able to share that information with us, I think it would help me.

THE CHAIRMAN: Thank you very much.

DEPARTMENT OF NATURAL RESOURCES

THE CHAIRMAN: I would now like to ask the representatives of the Department of Natural Resources to come up. Peter, would you like to introduce the other members of the team?

MR SUTHERLAND: Thanks, Chairman. My name is Peter Sutherland, Deputy Director-General of the Department of Natural Resources. I have with me Martin van Bueren, a consultant from Allens Consulting who worked on the submission, and Rick Rundle, senior policy adviser with the department.

Thank you for the opportunity to provide a presentation on our submission to the hearing. I intend to briefly cover the nature of our submission, the areas of the submission and the key drivers behind the submission, and then I'll ask Martin van Bueren to go through the remainder of the submission in terms of some of the detailed costing information.

Can I just state at the outset the reason for engaging Allens Consulting in this task of working with us on the submission was to ensure that we had a degree of independence in terms of the quality assurance associated with the costing material and the overall modelling and forecasting. I think that has been an important part of the process.

In terms of just the background and context to our submission, I think most people would be aware of this, but DNR, as DPNR, previously lodged an interim water resource management pricing submission to IPART for the current financial year, 2005-2006. IPART released its determination on those water resource management charges for this current year in August.

In that submission we foreshadowed a longer-term submission and we indicated that there would be a significant overhaul of the costing information and updating of the costing information in this current submission. We submitted this medium-term submission in September, and this current year has allowed us to analyse the implications of the changes brought about by significant water reforms over the last couple of years.

I think it can't be understated the significance of

these water reforms. In fact, I think when people look back in hindsight on these reforms in a decade, they will be seen to be quite revolutionary. In fact, they are akin, in terms of the extent of the reforms, to property rights in relation to land. What has actually happened in this last couple of years has been a major overhaul of the property rights basis for water resource management in Australia and New South Wales.

I just want to recap on some of the key initiatives there. Amendments to the Water Management Act 2000 that were implemented in June last year, at about the time that COAG signed off on the National Water Initiative, brought into place for the first time in New South Wales perpetual access entitlements as a share of the available resource compared to previously 15-year entitlements or licences. In addition, we commenced 31 water sharing plans, representing about 80 per cent of the resource. They covered regulated and some unregulated systems, but certainly the bulk of the resource used in New South Wales.

In addition, six ground water plans were deferred pending further work with the Commonwealth to develop a major structural adjustment program in relation to six ground water management systems. That program is now commenced. There is $110m being invested by the state and commonwealth governments in assisting with the structural adjustment to bring those systems within sustainable yield.

In addition, the changes and amendments to the Act last year brought in an independent Natural Resource Management Commission role in relation to reviewing water sharing plans and also gave roles to CMAs in terms of the management of environmental water. Those reforms were then backed up with regulations in relation to licensing provisions that Abel referred to, which significantly clarified the issues to do with modernising access licences, approvals, consents and registers. In particular, the government has committed to effectively a guaranteed register which will be equivalent to Torrens title in relation to land transactions.

In terms of trading itself, there have been significant increases under the legislation already in relation to improving opportunities for trade, and that's going to be built on in the amendments to the Act that are being introduced in the House as we speak.

In terms of the water sharing planning process, we have commenced work on macro plans provided for under the amended legislation to address the remaining particularly unregulated systems representing about 20 per cent of the resource, but about 70 per cent of the actual licence holders.

In terms of the current amendments to the Water Management Act that were introduced into parliament last week, they will complete the legislative requirements under the National Water Initiative, particularly in terms of the risk assignment framework, the removal of barriers to trade from irrigation corporations and clarification of environmental water provisions.

I think the significance of those reforms can't be understated either, because effectively what we have moved from is a situation of licences, 15-year licences, and water sharing plans at the end of which entitlements could be adjusted at will by government without compensation to a system of property rights based on perpetual access shares and a transparent process involving an independent NRC at the end of a water sharing planning process of 10 years that now will involve risk assignment between irrigators and governments which will minimise the liability of irrigators based on changes to water sharing plans in relation to policy or scientific evidence to effectively 3 per cent. That is a significant reform in terms of increasing the certainty and the investment environment in which the irrigation sector can operate and has created now very much a tradable and bankable entitlement.

In terms of the National Water Initiative - and I will just give you an indication that that is the size of the implementation plan for New South Wales, 95 per cent of which needs to be delivered on by the Department of Natural Resources - the National Water Initiative has brought about significant requirements in terms of modernising water resource management. It builds on the COAG reforms, including full cost recovery as a principle.

The implementation of NWI includes very many initiatives in terms of improving the accounting of water, the measurement of water and the dealings and trading arrangements in relation to water. It will bring forward and require acceleration of the need for New South Wales to

complete all its water sharing plans by 2009. It requires further developments in relation to our water title register, which will be required to meet national standards in terms of water accounting. It will not only increase facilitation of trade within New South Wales, but from January of next year will significantly open up interstate trade, and there are significant obligations on New South Wales in relation to implementing those reforms. So we can see that, in terms of the key drivers, we are now in an environment that is quite different from the environment we were in in terms of 2001-2002, and certainly our holding submission for 2005-2006.

In terms of this submission, it responds to IPART's 2004 issues paper, the determination on our 2005-2006 submission, and it deals with DNR's new obligations in implementing the National Water Initiative, in particular that are dealt with in the NWI implementation plan, and the legislated water reforms that have been required to give effect to those COAG agreed reforms.

The submission revises the cost base to cover all the elements of water resource management activities that are consistent with the National Water Initiative principles. It provides costing information to IPART to both set the water resource management charges for the next four years, but also to set the fees in relation to the transaction charges in terms of Water Management Act consents.

The key proposals in the submission relate to a new basis for developing cost shares, which Martin will go through, a simplified tariff structure with a single water resource management entitlement charge which recognises that water resource management costs are primarily associated with fixed charges about protecting the resource and the property rights of users and they are not about variable charges associated with water service delivery.

There are other aspects in the submission that go to the case for the removal of wholesale discounts for irrigation corporations and removal of security premiums on regulated river access charges because these are carry-over requirements that relate primarily to water service delivery arrangements and not water resource management charges themselves.

I would now like to call on Martin van Bueren to provide some detail in terms of the actual costing forecasts and the rationale behind the proposals in relation to cost sharing.

THE CHAIRMAN: Thank you.

MR van BUEREN: I would like to provide you with a cook's tour of what's in the submission. Unfortunately, time doesn't permit to go into all the intricate detail, but I'm sure in question time it will allow some greater focus on some of the detail.

First, the Allen Consulting Group, in conjunction with Danu Consulting, an accounting firm, were asked to prepare the cost data for the Department of Natural Resources. We were not tasked with the job of producing a financial model to forecast prices, and I think that's a very important distinction to make. That was beyond the scope of our submission. It does not propose prices. It proposes unit costs that are reported on a dollar per megalitre of entitlement basis as a means of benchmarking costs across valleys and different water sources.

Again, the unit costs shouldn't be interpreted as prices. Total costs are reported, but not the user shares in these unit costs, so we haven't gone the next step of saying, "Well, if you've got $2.50 per megalitre as a unit cost, what would that mean as a price in terms of a user share?"

The per megalitre entitlement costs are not comparable to the existing two-part tariffs because, of course, it's just on a per megalitre basis, entitlement basis, and also the third point where you'd come unstuck as interpreting those unit costs as prices is that the actual allocation of costs and tariff setting we believe is an IPART role where social objectives and other considerations about the relevant allocation of cost to particular valleys for the purposes of price or cost recovery is not really a consideration that should be made by the DNR.

I would also like to advise that the submission by DNR should be read with reference to an addendum which includes a $2.1m downward revision of DNR's annual forecast WRM cost. This, regrettably, was due to a data compilation error in our post-submission validation checks of the costing model. So I would just like to draw your attention

to that addendum, which I believe will be posted, if not already, on the IPART web site.

What is WRM? There are four main points there: activities to promote resource sustainability; activities to manage the impacts of extractive water use; activities to promote the integrity of the entitlement system and security of access - and I think that third point is really where the department has migrated from the 2001 determination, where there's much greater emphasis on security of access of property rights; and the department also undertakes licensing activities, namely, consent transactions and dealings.

The overall map of what is in the submission can be summarised quite simply with this diagram. On the left, we started with the task of working through four years of historical data up to the period 2004-2005, and then we looked at developing some forecasts in close collaboration with the department for the next five years going out to 2010-2011.

From those costs, we then worked out, per megalitre of entitlement, unit costs and then established the actual incidence of those costs - where those costs were actually being generated and where the drivers were, by valley and by water source.

The fourth or the fifth step here in this diagram is to try to assess what percentage of these costs should be passed through to users as user costs versus government share. But I do stress that the actual allocation of costs and tariff setting of these costs to different valleys and water sources is something we see as an IPART role.

This slide shows the historical costs and the forecasts. In the historicals, we are looking at about a $45m average over the four years - $43m to $45m in WRM costs alone. Moving forward, there is a forecast increase in expected costs associated with WRM. As I will explain, that is largely associated with implementation of the NWI and the water sharing planning.

The forecast costs are around about $53m. So the forecasts are expected to rise by about 16 per cent in real terms on historical 2003-2004 levels due to the implementation of water sharing plans and new commitments under the National Water Initiative. The cost increases are mostly attributable to additional staff required to resource these activities and it is expected that an additional 23 staff positions will be required over and above the 2003-2004 levels. That would equate to about three additional staff per region. In return, users are to benefit from having more secure, bankable and tradable water entitlements as Peter Sutherland mentioned. A basic breakdown of expenditure by type indicates that remuneration is over 50 per cent.

We also have established a breakdown of costs across different water resource management activities. There are a full 60 activities in the submission that we have broken these costs down by. This chart summarises the 12 main groupings. You can see that a lot of the costs are associated with planning and water sharing plan implementation.

This is an interesting chart because it provides a snapshot picture of where the water resource management costs are really tied up and what they are associated with. On a basis of the grey bars being the total costs, they are by far the greatest in regulated - about 44 per cent of the total costs. Then going down to unregulated it is only about 30 per cent and about 26 per cent is associated with ground water on a total cost basis. But when that is expressed as a per megalitre of entitlement, then we see a different picture. Given that regulated water has a lot greater entitlement volumes associated with it, that becomes the lowest unit cost.

We have presented information about the cost incidence by valley in the submission. I will not present that here due to limited time. In doing an analysis of DNR's costs we do see that costs vary from year to year across different valleys depending upon the stage of the planning cycle, which the department is working on. There are seasonal requirements such as occur in localised areas of drought. So it is not quite accurate to really class particular valleys as being high-cost valleys every year, but there are some state-wide activity costs that are allocated uniformly across all valleys.

Having said that, there are some valleys that do tend to be at the higher end of the scale in terms of the costs of service. That tends to be those valleys where there are

a large number of small licence holders, users dispersed over a large region, low volumes of entitlement, and those areas where there is a requirement for protection of high-value environmental assets. I might say that all those costs are not necessarily passed on to users. At this stage we are talking about total costs.

In determining the user share of costs, IPART's 2005-2006 determination provides for approximately 65 per cent of water resource management costs to be recovered from users. However only about 36 per cent of the cost base is actually recovered. DNR is proposing that that user share should increase to approximately 85 per cent, and that is to reflect the increased user benefits from protection of entitlements, a secure trading system and all the costs associated with that system. There is also an expectation that the water users should contribute towards the cost of meeting environmental objectives set out in the water sharing plans.

This table just quickly summarises what was in the IPART 25-2006 determination and compares it with what the DNR is proposing in its distribution for 2006-2007. The total cost base determined by IPART for 2005-2006 was about $51m. In the submission being made by the department, we are saying that the cost base is estimated to be $53m.

We have talked briefly before about the user shares and the difference between those. The figure beside the line on this slide reading "Revenue from current tariffs" is around $18m. So what I have done here is demonstrate what proportion of that revenue is to the user share of costs under each of the two - the determination and the submission. You can see that obviously in the DNR submission, the recovery ratio is somewhat less because of the arguments for a higher cost recovery user share.

I won't go into much detail on this slide, but it is really to demonstrate that there are a whole range of different tariff structures out there applying to recovering WRM costs at the moment, depending on the nature of the water source and whether or not it has a volumetric licence associated with.

We are proposing to sweep away the complexity of this whole maze of different tariff structures and to bring in an entitlement charge based on dollars per entitlement -

megalitre of entitlement. This is not to say that there will be a uniform charge across every valley; there will still be differential charging across valleys but it will based on a single basis. Peter Sutherland has already talked about the rationale behind that proposal. I will not go into too much detail about it and I am sure we can discuss that in question time.

Turning to security premiums, the DNR is proposing to remove the price premiums on the high security licences simply because DNR no longer undertakes a water delivery function and hence most of the cost of ensuring high reliability water is an infrastructure cost not a WRM cost.

With regard to wholesale discounts, DNR is proposing that these discounts be removed. The discounts currently apply to irrigation corporations and districts. The rationale here is that the discounts were originally granted in recognition of the metering services provided by the ICDs, and because metering services are no longer a role of DNR, it does not make sense to maintain these discounts. Discounts are a somewhat arbitrary at the moment as they are currently determined. So if there is to be any financial acknowledgment of any services provided by the ICDs, it should be on the basis of a service level agreement and full transparency, and the DNR is not shying away from that.

I have been given the wrap-up, so I will finish the discussion there. If there are any other questions, we can tackle as they come from the floor.

MR REID: Thank you very much. The National Water Initiative places great emphasis on consumption-based pricing. You are suggesting essentially a move away from that for natural resource costs. I just wondered how you reconcile the two.

MR SUTHERLAND: I think there are a number of elements to this: firstly, the NWI principle there particularly relates to urban charges in terms of tariff structures, encouraging of water use efficiency, and to the service delivery charges associated with consumptive use in irrigation areas. I think what you have to keep in mind in terms of the totality of the pricing requirements, if you like, for irrigators is that it includes State Water's charges and the water resource management charges.

We believe the water resource management charges are best defined in terms of fixed costs, because the sorts of charges that are involved in terms of water resource management charges are not of a magnitude that will lead to water efficiencies. The key issue in terms of generating water efficiencies in the rural water market is, in fact, the capital cost of water. Market tradability and the high capital cost of water are the things that will drive water use efficiency not the relatively small water resource management charges which represent a very small proportion of the costs of water.

I guess we see that as being quite consistent with the NWI principles as long as it is taken into account that we are dealing with the totality of water resource charges being borne by irrigators and the nature of the charges. We believe that there is really no substantive argument for suggesting that variable charges be applied to water resource management costs.

MR REID: You talked in terms of the operating costs moving from the Tribunal's determined figure of around about $51m in 2005-2006 to $53m in 2006-2007. The actual costs incurred in 2004-2005 are only around about $41m. What was the implication for the service provided in the 2004-2005 year for that much lower figure and what additional services will be provided and how can we be assured that the provision of those additional services is being done in the most efficient way, and has that provision been made and tested?

MR SUTHERLAND: There are three elements to that. You will see from the histograms that that 2004-2005 year was an anomalous year. It was the year coinciding with significant structural reform in DIPNR. There were significant constraints in terms of the processes of appointing staff. As you can see, and as Martin van Bueren said, most of the costs incurred in water resource management are in relation to recurrent staffing costs. So that year was an anomalous year.

We are completing the costing estimates for this current 2005-2006 financial year, which are missing from the histograms there, and we believe that that information will indicate that the levels of service have been reinstated in this current year.

So there were reductions in terms of the level of investment in the 2004-25 year. That has partly been addressed, as Martin said, by adjusting the cycle in terms of the rate of progress with planning activities and other activities across different valleys. So we are compensating for that in terms of readdressing where there were shortfalls in relation to that 2004-2005 year.

In terms of market testing, we have attempted to benchmark with other states. We believe that our costs comfortably sit within the norm, but it is very difficult to accurately benchmark costs with other jurisdictions because there is such a wide variation of institutional arrangements and disentangling the functions from annual reports and other information available on other states is very difficult.

We are certainly very keen to do further benchmarking, but it is a costly exercise because it really requires getting down into the organisational complexity and there are very few states that are alike in terms of the way they manage water and the division of responsibilities.

With regard to hydrometrics, I might just add, as it has come up, that the State Water Corporation provides $4m in terms of our services in relation to regulated systems relating to hydrometrics. We are now in the process of concluding a detailed review of our hydrometric services which will include benchmarking and comparison. So we are looking at market testing entire hydrometric services. We are looking at expansions of that network to include the unregulated systems, as the macro water sharing plans commence over the next 18 months to two years, as well as looking at upgrading the telemetric systems associated with those networks so that we get not only the most efficient operation but the best levels of service not only in terms of State Water Corporation but for irrigators generally.

MR SEERY: I want to ask one question. It relates to the graph that you put up with the total costs and costs per megalitre across the three sources, regulated, unregulated and ground water. I missed the number for the ground water, but I noted that for the regulated rivers, when you turn the total price into the cost per megalitre, you are looking at a cost of about $3; whereas for unregulated you are looking at a cost of around about $10. That suggests

that on a per megalitre basis - I can understand the fact that you have significantly smaller volumes in the unregulated reference - the costs are three times.

If you did a very simple extrapolation, and you would think that perhaps the charges should be reflective of those costs, then the costs would be three times in an unregulated river. I am just wondering as far as the users are concerned, why should they be paying three times the cost in an unregulated river for a similar service to that which is provided in a regulated river?

MR SUTHERLAND: I might just deal with that in general terms and then Martin van Bueren can fill in some of the detail. I think you need to recognise that the water resource management charges in relation to regulated systems are influenced significantly by the structure of the industry which includes the bulk of the resource being handled through six private irrigation corporations; so, effectively, we have six licences in those regulated systems in terms of the bulk water. As I said, the regulated systems account for about 80 per cent of the resource of the water sharing plans.

The unregulated systems, however, involve the majority of the licence holders - in fact, nearly 80 per cent of the licence holders. So there are significant systemic issues in terms of the nature of the licence holdings which impact, if you like, on the unit costs. Martin can provide some additional input.

MR van BUEREN: I think another dimension here is to consider what the implications are of passing over to users a simple average of the overhead costs and fixed costs associated with delivering the water resource management service. A lot of the difference in the $3.10 versus the $10 per megalitre charge is associated with spreading a large fixed cost component of overheads across those two user groups. If you average out that fixed cost based purely on a per megalitre of entitlement volume basis, then you end up with those differences.

I think something for IPART to consider is whether it is truly equitable to pass through all those fixed costs at the same level with the same proportion of fixed costs going to the unregulated as to the regulated.

MS CIFUENTES: Just looking at the proposal for looking towards this single charging system, how far have you taken that analysis in terms of the impact on individual customers, scenario testing, assuming broadly the types of usage prices?

MR van BUEREN: We have not made that a specific task of our analysis, principally because we weren't tasked with going down the track of discerning what prices should be for the various valleys. So I think we are floating this as an idea, as a proposal, without going down the track of looking it and examining the impacts. I understand that IPART will be engaging some assistance from consultants to look at impacts.

MR COX: This is on the cost shares, from 65 per cent to 85 per cent in your proposal which is quite an increase. You explained some of that was due to activities which could be charged to users. Is that the whole story or is there more that is driving that? I would be grateful for your information.

MR van BUEREN: I think that can be answered by a small answer from me and perhaps by a bigger answer from Peter. When we are looking at the cost sharing issue, it is really not an issue for economists to preside over. It is a philosophy or a government policy issue as to who should bear the costs of provision of environmental goods. Under guidance from the department, our team of economists developed a robust cost sharing framework based on a recognition of who has the obligation to provide for the environment.

We concluded that the water sharing plans do provide a basis of a level of environmental policy determined through objectives of the water sharing plan which we interpreted, and the department interpreted, as being a standard base line duty of care that should be met by the water users. Any increments in environmental quality over and above that base line duty of care would then be met by the government and the community. So that was our basic framework. Peter may wish to add to that.

MR SUTHERLAND: Only to say that I think it is a fundamental policy question here about the beneficiary pays principle or the impactor pays principle. Our view is that the previous cost sharing arrangements and the complexity

of those really aren't consistent with modern philosophy in relation to water resource management. They really don't enshrine the principles of the privacy of the environment in terms of water allocation processes and the importance in the modern water resource framework of protecting third party and environmental rights. Most of the water resource management charges are about protecting the environment from adverse impacts of uses that are inconsistent with water sharing plans or entitlements, or impacts on the irrigators arising from inappropriate activity of other users.

We believe that if you look at those principles and the fact that under our Water Management Act there is a clear primacy given to the importance of protecting the environment and the rights of other users that we have come up with a cost sharing arrangement that is now a lot simpler but a lot more consistent with the principles of NWI and our legislation.

THE CHAIRMAN: I observed there was a question about how quickly, and what might be the appropriate principles. We were due to have had a cup of tea by now. We will still have the cup of tea and we will resume in a quarter of an hour.

SHORT ADJOURNMENT

ENVIRONMENT GROUP

THE CHAIRMAN: I call on the Environment Group.

MR MOSS: My name is Warwick Moss. I used to work for WWF until about six weeks ago, so I am not formally representing WWF per se; I am an invited guest of the Nature Conservation Council but I am presenting a submission that is the product of the For Environment Group, so WWF, the Inland Rivers Network, the Nature Conservation Council of NSW, and the Total Environment Centre. Tony Trujillo is an economic policy officer within WWF and Cecile van der Burgh is a water policy officer at the Nature Conservation Council.

Part of what I want to say in our general submission is really just two points. But then, of course, because I can't help myself, I have probably another 50 points in response to everything we have heard today that we could get into. I want to outline the first two points, discuss a little bit of the history of the environment movement's involvement in this process, which leads to a third point, which is stepping back a little bit and maybe saying what is it that we want out of this process, given that over time it has become a very technical and detailed process, which in some ways I would argue now is in the minutiae of many of the issues, and we want to step back and say why we are here and what do we want to see.

The first point is that we want to see a price path. What we have seen - and I would firstly say that I think that the State Water submission and the DNR submission are much closer to it than ever before, and in many ways a vast improvement, and they really do take the issue of costs further. What we still don't have I guess is some sense of a price path. We would be saying it's a three-year path. State Water has shown a worst case scenario in one year but then they say they will do it in five.

We have heard DNR say, "Here are some costs but we don't want to go the next step and allocate a percentage, and this is what it will be." We want to go that next step and ask what are they. We want a three-year price path, and, secondly, we want commitment from DNR and State Water to implement that and start doing it.

Thirdly on that, as a slight issue, I guess we are

concerned that the South Coast, North Coast and Peel River situations are always seen in some senses as a reason not to make the full cost recovery explicit on the other valleys. I think what we should say, as State Water has said, is "they are different, we know we are going to have to do something different in dealing with that, and let's remove them in a sense from the mix but not hold anything else up". So in short that is what we want.

In the 10 years we have been involved in this process we've really never just seen that clarity of "this is the price path for the next three years and it will be full cost recovery". It will not be, "This is what we might like to get to, but we are only going to inch up and we still don't know when we will actually reach it."

The second thing is to say a little bit about the potted history of the environment movement. I must confess that we really do have a bit of a love/hate relationship with the Tribunal in the process - and I am sure that is shared by many. We know it is a very important issue. For example, when we are hear, as Peter Sutherland said earlier, that price is not going to send a signal for efficiency, it will be the water trade, and Alan's contribution to DNR clearly shows in their submission that the water market prices are going to be the thing that drives long term efficiencies.

So then as an environment group we are saying we want the water price up because we want to send a signal of efficiencies and we want externalities to be appropriately managed. That obviously puts us into a difficult position. We fundamentally believe that water pricing, even at the margin, must have some influence. It may not have the full influence as the water market prices, but it must at the margin do something.

So we are very stuck in saying we know there is research that can point either way, and we also know that when there is low water prices it is argued that the incentive effect will be lower. It is a natural approach then to say, "Let's get the prices so they are relevant and let's get that signal out there faster rather than holding it back, in a sense, knowing that for 10 years we have said we are going to raise it, but we are still inching."

What do we get out of this process? As an environment movement we came to this process 10 years ago saying things like, "Protection of the environment is really important", and quite naturally the Tribunal would say, "Well, that's all very well. We agree. How do we do it?" So then over time we have tried to get much more involved in the economics and, as many of you will remember, three or four years ago when the ACIL report came out and there was a debate about impacter and beneficiary pays, and so forth, we try engaging that on an economic basis and argue it through as technically as we could.

I probably sound a bit apologetic coming here to say that at the end of doing both of those things we are still really not sure what it is we can actually get out of this process from an environmental perspective even trying those approaches.

So the third part of what I want to say, given that sort of history, is a little bit of a step back about what we really want and how we are thinking we might be able to achieve that through this process, but also with the recognition that we have probably come to the point that other processes might end up being more influential.

What we really want is the environment to be improved. We came to the Tribunal a few years ago pointing out what the NSW state environment report showed, which was that over 50 per cent of the rivers were in significant decline. We also know that since then we now have water sharing plans in place which are argued to be either managing that problem or at least about to be manage that problem. We are still very early in those processes. So from our point of view we want those processes to be enacted and to get the results.

Next, on one level we almost don't care who pays. I say "almost" because I will qualify it. I think everyone who comes to this process ultimately feels that they are somehow losing out. So I would imagine that an irrigator comes to the process and says, "I am going to lose out. I am going to have to pay more money. I still don't trust State Water and DNR to deliver what I need. I think they are overspending. We want efficient costs. I am going to come out of this process suffering." However, we come through it in exactly the same way. So we, as the environment movement, say that if it is not charged to irrigators, then it is charged to the community, even if in

an indirect way, and we also don't know what we are getting. We are still getting declining river quality. So we are paying, but we are also not getting a clear result, that we are getting what we are paying for.

So this process still seems to me to be coming down to different sides trying to protect themselves and saying, "Gee, we don't want to get hurt", but the bigger picture still is how are we going to effectively manage it so that we can meet environmental and business and industry and community needs. I am wondering whether the process is coming down to battling out the details itself for protection rather than potentially going to an optimal situation.

What I mean by that is that one of our major concerns coming to this process has always been that the appropriate amount has actually been spent, or is at least planned to be spent to meet the environmental needs. So in many ways that is why we support the DNR submission in that the approach they have taken is estimating the water resource management costs and the share of about 85 per cent is something we have said before. We actually said 80 per cent three years ago, on similar reasoning. We support the idea of saying, "At least we are spending the right amount and that what we are spending is going to get a result."

Secondly, we do argue that there is a difficulty in saying that charging users appropriately is going to lead to all of our environmental outcomes. As I said, we don't know the stimulatory effect it will have. On a simple level, it is legislative, it is in the agreements, we basically know full cost recovery on the definitions that we have on the table. They may not achieve everything we want, but they are there, and we are saying 10 years later we are not there yet still, we want to be there. In opening that up we want to say, "Actually maybe it is not just full cost recovery that we are really needing here. What we are looking for is a bigger picture."

The final point on that would be to say that one thing we are very concerned about is looking at pricing as only one small part of the picture. We are saying if you only look at pricing and if you only look at it that if prices rise you might be adversely affected, then you won't look at the bigger picture which I think DNR has tried to present, which is the security in the new approaches is significantly worth something and in fact should be paid for, that there are massive gains to be made if trading is done appropriately, the water sharing plan system and the whole water management system should be a major improvement, and if you go further outside water, if you look at the general trend in society now, and certainly as an environment movement we support it, that we should be paying for environmental services, and we should be supporting sound management by irrigators and other farmers. It is in the whole context of the move towards paying for good management, and a system which is generally reinforcing people's rights, then to have this part seen as a negative but not necessarily done without seeing that the overall net effect is a positive for irrigators, we'd see that as a problem.

Another point that really concerns me is the treatment of externalities in general. What we have to remember of course is that under the definition, the reason we are charging for externalities on the basis of recovering the costs of what agencies incur in managing them, you have to remember that is only a proxy. The externalities are the damage that is caused by the activities. Again, that is an economic measure on the basis of who is suffering those externalities.

I know that the Department of Agriculture Fisheries and Forestry and the Department of Environment and Heritage have been trying to work this out. I have also argued to them that they are working it out very slowly, and the latest timetable I think is 2010 for a mechanism to deal with externalities. We have said to them before that is not going to help us, and a lot of people come to the Tribunal saying they are dissatisfied with this approach of dealing with externalities, but it is basically the best we have got. We can only go with the proxy method when we don't have anything else.

As I say to many irrigators who argue with me about this, "If you really do do a serious approach to externalities where you are working out the community value, then you can start bringing in mechanisms to get the community to pay on that basis." Why can't we have people, in a sense, purchasing environmental outcomes if we knew what they were properly. We can come up with different ways of managing externalities if we actually do the investigation and work out what they are. When we are

stuck in this mechanism of just what can we manage to get the government to spend that they feel politically safe in doing without being hammered on either side for not doing enough or doing too little, we may not be answering the real question we are trying to achieve.

We're out of time. There are some other points, but I think that gives the general context of where we're coming from.

THE CHAIRMAN: Thanks very much.

MR REID: Warwick, just taking that big-picture approach again, obviously charges have gone up, there has been money allocated for environmental spending. Has that been effectively spent and what has been the outcome?

MR MOSS: I think Cecile can probably answer if it has been effectively spent, but my first comment is I actually do genuinely say that I think that is a very positive improvement. I think we have moved away in some part from, for example, the fear that we can't do some of these things because we're not going to be able to have the prices passed on, or whatever. I think the agencies are moving to a recognition that these are important costs to incur and they can pass them on if they argue it correctly. So I think there's a positive potential. Cecile would know more about the reality on the ground.

MS van der BURGH: I think in terms of efficiency or effectively spent money, the on-the-ground outcomes at the moment for the water sharing plans are very much in a starting state. We haven't seen the outcomes on the ground as yet because they were introduced only last year.

As Warwick was saying before, the latest information that we have, scientific information, still says that our rivers are declining and we actually haven't recovered from the decline in implementing these measures yet. By having not a focused recovery in both the department and State Water, that will mean that we won't have that recovery happening.

I guess there's a lot to be done about efficiently spending the money, and it's great to have good plans on paper, but the implementation is really important, and having enough funding for the implementation and effectively spending the money on the implementation is actually the key to getting these outcomes, and we haven't seen those outcomes as yet.

MR REID: So what specific deliverables are you looking for and are they included in what's been presented by State Water and the department?

MR MOSS: Again, it will sound like I'm hedging it, but it's for a reason, which is that this is a question that often comes to us, and no matter how much expertise we have, we can't necessarily represent, you know, what, say, every river system should look like and what's happening in the water sharing plan process.

Where we have mostly articulated this and seen, I guess, the results is in the process of corporatisation of State Water, where we had, through IPART, the extensive discussion and consultation around what should be in and what shouldn't be in and where should it be? I'm far less worried about what State Water is going to do - Abel will be happy with that, probably - than I am in some ways about DNR, because, as we said, in terms of the corporatisation debate, it's really the effectiveness of the regulation and the willingness of the regulator to ensure compliance, to ensure, I guess, this water resource management is done that is far more of an uncertainty and a risk and basically a scare to us.

I would just say in answer, Colin, I think it's too early for us to tell whether DNR is really up to it, especially now with another round of their restructuring right now in the process. It may still be a while before they're fully up to the task.

MR SEERY: Martin van Bueren in his talk earlier stated that there's an expectation that water users should be meeting the cost of achieving the environmental outcomes in the water services plan. Some people could argue that other bodies should be paying for it, like the environment sector themselves, or government. What's your view on that?

MR MOSS: It's such a complicated area. I do understand that. We are supportive of that position, and we have said that before. I guess I want to answer it by making a point that I really wish I'd made earlier, which I think is

fundamental to us. We believe that in some ways it almost, like I say, doesn't matter in the end who pays. You can argue your principles either way. The first step is saying that they are paid for. Then, in arguing the case, I would still argue that, yes, they should be paying, but then you come down to the other side of it, which is what if, by doing that, you adversely hurt them in a way that is just not possible for their business, that someone else should be paying it because, say, for subsidy efficiency grounds, you know, we get an optimal outcome by subsidising it.

Now we're saying, "Let's not use then price to make that subsidy. Let's make that subsidy explicit and direct by saying, for example, okay, yes, Fisheries is bearing that cost, and it should, or Department of Environment is bearing that cost, and it should. But I think at the moment we have a confusion around that.

So, yes, I would say ultimately I would be agreeing that water users should pay for it, because I think it is related to their impact, but if a case is put that in fact someone else should pay for it and it's acceptable that they do, then the same sort of principle should apply. It should be clear why they are doing it. They should be held accountable so everyone knows that we're getting a result from what they are spending, it is efficient. Ultimately I cannot decide that other than on principle, I think, water users should bear the cost, or a proportion.

MR SEERY: Okay. Thank you. You mentioned that you're looking for a three-year price path, and I assume that you expect the agencies to be at full cost recovery at the end of the three years.

MR MOSS: Yes. Can I say why I think that is appropriate?

MR SEERY: Yes.

MR MOSS: I think it is because we were - not in this room here, but three years ago - discussing a three-year price path. Obviously the Tribunal decided not to reach full cost recovery at that time, but we are saying now it has been certainly many years that we have been talking about reaching full cost recovery, and, as I say, on the table so far we have had a one-year worst-case scenario with a five-year proposal, if you like, from State Water. Three years then, in a sense, sounds extremely arbitrary.

The argument that we would simply put is that it is not just three years, it is three years out of a 10-year process, so I think the signal has been sent that we'll be getting a full cost recovery in a reasonable time. We have done three-year price paths before. Why can't we do that? But we would also agree that the one-year proposal that came out in State Water looked pretty horrific. So we do agree that it looked pretty worst case.

MR TRUJILLO: Can I add to that? I think State Water has done something really kind of unique, at least from my memory, anyway. They actually have presented what it takes to get full cost recovery by valley. They showed it as a one-year projection, which makes it look pretty dramatic for some valleys. But in looking at those numbers, it seems to me that there's no reason why you can't make a case for achieving full cost recovery, for delivery costs anyway, over a three-year price path.

Also, I think in our submission we have asked that the agencies, both State Water and DNR, put together a price path to achieve full cost recovery, which we haven't seen yet from anybody, just so at least we have an idea, irrigators have an idea, of what it would really take to get there. I think it's very important to be able to see that. Then you have a case to make an argument it's possible or not possible.

I think what we have seen so far really doesn't give us the basis for arguing whether full cost recovery can be achieved over a certain period, because nobody has bothered to forecast it out. That's one of the things we'd ask the Tribunal to have the agencies do.

MR SEERY: One final question, and that relates to the Department of Natural Resources' proposal to have a fixed dollar per megalitre water resource management charge. I was wondering what your view is on that approach and how it meets your environmental outcomes.

MR MOSS: I think it comes down to, again, the initial point that Peter Sutherland made, is that going to provide an efficient signal, or not? I would hope it does, and we are then, in general, in favour of a consumption-based signal that says, okay, maybe we can do something about it by changing our management regime and avoid that cost.

We're totally supportive of that.

It does seem, though, that, given the amounts involved and given issues like, you know, drought - I think they make the point in the submission that in drought sometimes they do need to actually incur more cost to manage the resource, and if it were done on a per megalitre basis, that might be difficult for them, because in fact the expense they incur is opposite to the actual water signal at that time. So I would actually say that, on my look at it, it's a reasonable approach, given that, again, we're based on proxies.

The point is if they incur that cost and that's a genuine efficient cost and it gets a result and therefore is justifiable to pass on, it almost then becomes a bit administrative, do they try to send it on as a bit of a signal through the user price, or not? That's up to you to decide the technical details, but I don't think it would be an issue for us.

MR COX: Perhaps just one question. I think you said you felt we shouldn't be held up by the issues of the North and South Coast and the Peel in deciding what's appropriate generally. I'm not sure I quite understand how you feel the North Coast and South Coast should be handled. Perhaps you could clarify that point.

MR TRUJILLO: I'll come in on it first. Yes. I think it is true, if you look at the numbers you get, those valleys - North-South coast, particularly Peel - are going to have problems with full cost recovery, there's no doubt about that. I think they have to be looked at separately from the rest of the valleys that are obviously able to achieve full cost recovery. In some cases it doesn't seem like it will be that difficult. We looked at the Murray and the Murrumbidgee as far as delivery cost and it seems to us that the total cost that will have to be incurred by those valleys to get full cost recovery is not that much, particularly compared to the value of the water.

But I think that some look is going to have to be taken. This is probably outside of a pricing regime, saying, "Well, okay, those valleys are not going to be able to recover", in which case you have to then look at those valleys specifically, do a study of those valleys, for example, and say, "Is it economic to keep on providing water, or not?" If they can't pay for even the variable delivery cost of water, should the state be providing water?" Maybe they shouldn't. Maybe there's not an economic justification for it if the water is so expensive. But they have to be looked at separately, I think separate case stood aside and looked at to see the viability of it, of continuing supply or not continuing supply. If they have to be subsidised, then the government has to be aware of how much they are subsidising water to these valleys. It has to be transparent.

MR MOSS: If I can make an additional point, taking it away from that example, one of the things that I guess we raised three years ago, and I feel it was a misunderstanding or we did not communicate it appropriately the way we meant, and the IPART determination was at odds with what I think we meant, what we are recognising, getting to the kind of full cost recovery that we're talking about, is that there is then obviously a recognition that there'll be some people who will be really hurt by it, whereas Tony is saying in that case it just wouldn't even be feasible to get to that point.

What we are suggesting is that we need to try to take those out as much as possible and deal with them in other ways, which then, unfortunately, moves maybe into a general New South Wales Government approach and not an IPART one necessarily. But, for example, to not raise the full cost recovery price or charge because a proportion of people won't be able to deal with it to us doesn't seem a good enough reason.

We are very concerned about these people and think they need some support or a mechanism, but we don't think the response is to keep the price down. It is to say to another part of government, or whatever, "You have to handle this. It's a serious problem, a serious outcome of our decision, and we don't want these people adversely affected", and have that done.

So it is a similar case here, we're saying, "It's something that maybe we can't deal with if we're really trying to get the right charge because it's another factor that's kind of holding us back." We may not have an answer, but at least let's put it somewhere we know Abel is working on it and others. Let's do that in another way.

THE CHAIRMAN: I think we might leave it there. Thank you very much for your presentation. It's interesting to see the bigger picture beyond the economic rationalism.

NEW SOUTH WALES IRRIGATORS COUNCIL

THE CHAIRMAN: I would like to call now on the New South Wales Irrigators Council.

MR THOMSON: Well, good morning all. Thank you, Mr Chairman, for the opportunity to present here today. I think the IPART process has been a very worthwhile process. This has been introduced in, what did you say, 1996-97? I think there's an opportunity for everyone to come here and put their case forward.

You become quite well aware, Mr Chairman, of the dubious claims by some of the proponents who want huge price increases and those on the other side of the fence who will argue very strongly that those price increases should be in fact almost non-existent. That will be your decision in the future. For the case this morning I invite Doug Miell, our Executive Director, to present the case for New South Wales Irrigators Council.

MR MIELL: Thanks, Col, and thanks to IPART for our opportunity to again participate in this forum. As Col Thomson, our Chairman, said we support the IPART process. It is rigorous. It certainly puts a degree of confidence in industry that the submissions that are put forward by State Water and this year the Department of Natural Resources are assessed. The independent consultants review that comes forth adds another layer of that confidence. So we thank IPART for the conduct of the process and, indeed, State Water and DIPNR for giving us the footballs to kick around, ambit and otherwise, that might the claims be included.

Council's submission this year - again, thanks to the indulgence of IPART, we saw it as an opportunity to reserve our judgment on the capital, opex and asset planning issues of both submissions until such time as the independent consultants, PB Associates, have delivered their draft report in January. So we will certainly be making substantive responses to that, but not until that time.

One of the key issues that the council has identified in both the State Water submission and the DNR submission is the extent to which they both rely on the National Water Initiative to justify the changes to their business operations and what we see as unrealistic price increases

proposed in their submissions. We contest these claims and we do not support this new focus of the NWI to be one of a transfer of wealth from the irrigation sector and licence entitlement holders to government.

Both the State Water and DNR submissions seek to impose selective and one-sided interpretations of the National Water Initiative on entitlement holders. They fail completely to articulate community service obligations to the account of the State and seek to penalise regional communities dependent on irrigated agriculture through the introduction of some of the most Draconian level of charges ever dreamt up, I think, in the history of water pricing. We only have to look at the unconstrained price proposal that was put in the State Water submission, I think, to support that.

In support of many of its arguments for price increases, State Water conveniently stands behind the cloak of targeting and invokes various National Water Institute principles, yet at the same time conveniently ignores other principles when it suits its preferred position, or perhaps it's merely being compliant with the shareholders' wishes. If implemented, the unconstrained prices submitted by State Water will severely constrain licence entitlement holders' ability to exercise the privileges of their entitlements.

If the National Water Initiative is to be the vehicle by which governments, both state and federal, seek to substantially diminish our council members' ability to exercise that preference of their entitlements, to invest, employ and contribute to the wealth of regional New South Wales and the wider national economy, then it's my council's view that the National Water Initiative has probably run off the rails and requires a major review of its direction and purpose.

Council also contends that both submissions are at odds with the objectives of the National Water Initiative, which states in part that the initiative "so optimised economic, social and environmental outcomes by achieving", and there was a whole raft of things it was going to achieve. There are many examples where we believe both submissions fall foul of the principles of the National Water Initiative. It's the view of council that economic and social certainty will be diminished by the imposition of the selective application of the full cost recovery principles of the National Water Initiative in the manner outlined in both State Water and DNR's submissions.

Council supports the principle of full cost recovery for the services provided by both State Water and DNR to licence entitlement holders that are essential for the efficient management, storage and delivery of the State's water resources.

Council's support for full-cost recovery is predicated on the following key principles being applied to both State Water and DNR: That the role of DNR is restricted to regulatory functions only; that the maximum degree of contestability be applied to all aspects of the operations and service delivery functions provided by both State Water and DNR; that there be maximum application of variable charges by both Sydney Water and DNR; that no dividends be payable to government for services that have been not been subject to rigorous market contestability; and that a community service obligation be provided to those systems where full cost recovery is not realistically achievable, such as is the case in a number of coastal regions.

Council also contends that the State Water submission probably offend two of its "Other Objectives" as stated in the State Water Corporation Act; namely,

(b) to exhibit a sense of social
responsibility by having regard to the
interests of the community in which the
corporation operates...; and
(d) to exhibit a sense of responsibility
towards regional development and
decentralisation in the way it operates.

We believe that in no sense does State Water endeavour to place the price demands it is seeking in the context of its obligations as outlined in the "Other Objectives" of the State Water Corporation Act. We don't believe they have demonstrated that it has done that at all.

Similarly, the DNR submission contains a shopping list of options for increases, all based on compliance with various principles in the National Water Initiative.

Both State Water and DNR have exhibited no evidence of competitive testing of service delivery and quality of

service, nor have they even asked the most basic of questions: is the service actually having any value at all; is it required?

It is therefore critical that this IPART bulk water determination explore all issues associated with both bulk water storage and delivery and water resource management in New South Wales. In the absence of any meaningful contestability in either State Water's or DNR's market and with national benchmarking of dubious value, IPART must undertake the most detailed scrutiny possible of the proposals submitted by the both State Water and DNR.

The role of PB Associates will be critical in this IPART review. Council recalls the stinging criticism contained in the MJ Cardno report into State Water last year and seeks and hopes for a similar report from PB Associates on the proposals by both State Water and DNR.

One of the themes of both State Water's and DNR's submissions is the extent by which the delivery and value of property rights is enhanced by the services provided by these two organisations. This concept is also used as a justification for additional charges and a significant increase in staffing numbers and associated costs.

New South Wales Irrigators Council encourages governments to focus on the investment, employment and wealth-creation opportunities created by irrigated agriculture in New South Wales and not to view this sector through the prism of an opportunity to siphon off revenue in support of a bloated bureaucracy.

The council's preference is for a price regime that is founded on both State Water and DNR delivering services in a competitive business environment with maximum contestability applied to all aspects of their operations.

While the corporatisation of State Water marked a significant milestone in the history of storage, management and delivery of New South Wales bulk water supplies, it is now abundantly clear that, as a business entity, State Water was not "business ready" for corporatisation and, as such, has been hampered in its ability to implement business practices that deliver efficient, effective and cost-effective services.

The cost of corporatisation has risen markedly. State Water is seeking to impose those costs onto entitlement holders and this approach is not accepted by the New South Wales Irrigators Council.

While my council supports the commercial focus outlined in the State Water Corporation Act, State Water's submission merely pays lip service to the implementation of this principle. There is still a clear intent on State Water's behalf to simply pass off to entitlement holders all forms of risk without exploration of sound business planning and risk management as an alternative proposition. Only a state-owned monopoly could propose an immediate move to the gold-plated upper bound pricing including the maintenance of fixed charges, dividends to government, the one standard deviation principle, and a move to a full cost recovery ahead of any commitment to expose its business to full and open market contestability.

As with its submission into the previous IPART review, this State Water submission again contains no discussion on cost-reduction premises. During a period where there has been prolonged drought and reduced water allocations, down to zero in some instances, State Water's responses have been business as usual.

It is inconceivable that State Water management could not have employed business strategies to demonstrate to its customers that it was actually in touch with the reality of the environment within which its business operates and significantly prune its costs accordingly. All we tend to hear from State Water is that it is the only business in existence that has no ability to refine its cost base.

State Water, on a number of occasions in its submissions, provided details of government's past failure to meet in full its obligations as determined through IPART's bulk water determinations. My council again requests IPART to undertake and publish a reconciliation of compliance with each of its past bulk water determinations by both licensed entitlement holders and government, covering both capital and operating expenditure. That is basic accountability and a demonstration to licensed entitlement holders that they are not the only group being held accountable for the financial obligations imposed by IPART determinations.

Council is again disappointed that the State Water submission to IPART is incomplete in areas of innovation, community service obligations and commitment to regional development. It has not articulated how it intends to meet the obligations outlined in the State Water Corporation Act, which are:

(b) to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates

... ...

(d) to exhibit a sense of responsibility towards regional development and decentralisation in the way in which it operates.

The DNR submission to this review also seeks to impose price increases on entitlement holders under the pretext of compliance with the National Water Initiative. In particular, the impact of the NWI and water management planning are identified as being the underlying policy areas driving the need for a higher lever of water resource management activity.

The NWI clearly attributes the cost of policy changes to government on behalf of the wider community interest. In this instance, the Irrigators Council recommends that WRM activities undertaken in response to the National Water Initiative and National Competition Policy requirements are fully attributed to the government's account.

As with the State Water submission, DNR seeks to justify a large proportion of the changes it is proposing on the provision of property rights. The notion of competitive, contestable service provision to deliver high-quality least-cost services does not appear to be a feature of DNR's submission.

DNR has adopted a new activities profile for this submission. The new system contains 60 new activities, or the activities put into their new system. These activity groups contain many areas of service delivery that clearly fall outside the regulatory role of government as council sees it.

We have reviewed these activities groups and we suggest that a tight allocation of responsibilities for DNR would lead to greater transparency of service provision together with achieving the benefits of contestability at every opportunity. This will place a limitation on the scope of DNR's role while providing a very clear elaboration of those services that can be competitively provided by other service providers without any diminution of accountability of the service provision or policy implementation and market regulation.

The New South Wales Irrigators Council proposes that the regulatory role of DNR must be more clearly defined to include only those areas of regulation that cannot be satisfactorily performed by either the private sector or any other government agency such as catchment management authorities or even State Water. Those areas of WRM activity that council believes should be DNR's only activities include: water modelling and assessment; WRM planning; water consents administration; and water consents transactions.

When we look at all of the other various groups, we believe that they can be very efficiently delivered in a competitive nature by either State Water, catchment management authorities, the Natural Resources Commission in some roles, or perhaps the private sector through or under the auspices of the Irrigators Council.

Such a tight operations focus for DNR would provide entitlement holders with the confidence that commercial imperatives may start to drive water resource management in appropriate areas and reduce the opportunity for rampant bureaucracy to waste the resources of the state, industry and regional communities.

NSWIC asserts that policy development and plans and strategies to manage the state's water resources are a genuine role of government and must be fully funded from the resources of the state. This would ensure equitable treatment of natural resource management when compared with other areas of government policy and service delivery.

The council opposes the DNR proposal to add further staff to its WRM workforce. In proposing these increases, DNR has demonstrated it has no strategies to employ technology solutions, seek outsourced options, realise

productivity increases, privatise elements of its proposed WRM functions, or simply demonstrate why certain activities need to be undertaken by DNR at all.

While many aspects of both the State Water and the DNR submissions are supported either in principle, in part or in full, the pricing outcomes proposed by State Water and DNR are both completely rejected but will be further explored in response to the PB Associates report early in the new year.

Mr Chairman, in closing, the Irrigators Council and its members strongly believe that irrigated agriculture in New South Wales has a strong and vibrant future if it is supported by a government willing to help it succeed and prosper. The council's vision for irrigated agriculture is founded on the desire to work with government to implement policies that are balanced, equitable with other industry and community sectors, policies that are progressive and recognise the long-term value of sustainable food and fibre production in New South Wales and Australia.

Unlike other IPART determinations, this particular one has a heightened sense of urgency underpinned by the exposure of the pricing propositions promoted by State Water and DNR. I am sure my colleagues will elaborate on many of these issues later in the proceedings today when you open the hearing for questions from the floor. Thank you very much.

MR SEERY: I want to ask Doug Miell the first question. The council, in its submission, supports State Water's proposal that the high security premium should be reflective of costs. However, you do express concern regarding the potential impact of their proposal on high security premiums on your irrigators. Do you have a view on what the security premium should be and what principles should the Tribunal consider in setting the premium?

MR MIELL: Thanks, Michael. The first point is each water sharing plan in each of the valleys certainly identifies the basis for the break-up between general security and high security. That should, in the first instance, be the starting point, obviously being subject to negotiation within each valley; then I suppose one should ask what is actually the definition of what is the cost? So again we come back to recognition of the cost basis.

The principle that higher security allocations are consuming more of the State Water resource is supported. It is just a matter of ensuring that the equity is there and that it does actually reflect the circumstances which each valley has laid out in its water sharing plans. Again at a later point, some of my colleagues may wish to elaborate on specific elements as they relate to their valleys.

MR THOMSON: May I make one point? On the high security low security differential, in Murrumbidgee, of course, the high security element of water there is covered by the Snowy Hydro's minimum releases, so it is quite different from the rest of the rivers within the state.

MR SEERY: One area that has not been given much attention today is that of conveyance licences. As I recall from the State Water submission, this is an area where there could be some contention. I was wondering if you have any views on how these licences should be charged?

MR MIELL: From my point, that is a question I would like to defer and pass on to representatives from the Murrumbidgee and Coleambally, and perhaps Jemalong. That is an issue that relates right to their operations and their level of expertise. They are probably better placed to give you an answer to that, if you do not mind.

I know John Howe is in the audience here, and perhaps Ted Morgan from Jemalong, may be able to assist you, but it depends whether you want to do that now or hold that question for a little later.

THE CHAIRMAN: We will do that straight away.

MR MIELL: John Howe, would you like to address that from Murrumbidgee's point of view?

MR HOWE: John Howe from the Murrumbidgee Irrigation Corporation. We see the whole question of inter-valley cross-subsidisation involving the treatment of conveyance losses and the treatment of wholesale discounting as a very important issue that warrants a separate study. We don't believe it should be treated arbitrarily, sort of putting one's finger in the air, and we would encourage IPART to support that study

MS McLEOD: Jenny McLeod from Murray Irrigation. This is an important issue and we will be adding to it further in our submission. Currently, Murray Irrigation pays for its conveyance licence, and that is different from some of the other irrigation corporations. We also pay on the basis of it being a high security entitlement, when actually only half of it is a high security entitlement.

The issue needs to be dealt with in terms of what you actually assume as a whole valley entitlement and use. When you do your calculation in terms of the revenue you need to collate, and I suspect that is where some of the differences between the valleys have occurred. I support John's comment. It is an issue that needs to be considered in quite some detail and there have been some differences in terms of how the irrigation corporations have been charged over the last 10 years for their conveyance component.

MR MORGAN: Ted Morgan from Jemalong Irrigation. Could you just repeat the question, please? I didn't hear exactly what the question was.

MR SEERY: Basically I was asking what your views were on how the conveyance licences should be charged.

MR MORGAN: Conveyance licences or losses?

MR SEERY: Well, losses.

MR REID: Licence fee.

MR SEERY: Licence fee for conveyance losses.

MR IMMARAJ: They are conveyance licences now.

MR MORGAN: In Jemalong, we pay for the losses that go through, so I am not quite sure what the relevance is.

MR SEERY: It probably is less of a relevance for you than it is to the Murrumbidgee.

THE CHAIRMAN: I think we have got the message. It is big enough to do some further work on separately. I didn't intend to throw the whole thing open to the floor at this stage, so we will move back to the secretariat.

MR REID: I noted John Howe's comment on the wholesale discount. I just wanted to touch on that topic in a bit more detail. Both State Water and DNR are proposing that, where the irrigation companies perform functions for them, it will be on a fee-for-service basis rather than this more broadly based discount. I am just wondering what your reaction to that is.

MR MIELL: Again you have asked a question that goes right to the heart of operations by some of the larger corporations, both Murrumbidgee and Murray. The council does not support the removal of bulk water discounts with respect to the corporations, but it is a complex issue that again I am going to defer to my colleagues, mainly because it is one of those issues that really relates to the specific element of how their corporations were privatised.

It does impact on all of the privatised corporations to varying degrees, but they will vigorously be contesting the retention of those discounts for operational reasons as they see it, and for historical reasons. Again, Mr Chairman, depending on your will, that could be elaborated now or perhaps at a later point.

THE CHAIRMAN: We will hear from one or more two people.

MR MIELL: Once again, I think John Howe and Jenny McLeod would be the people with the depth of experience on that issue.

MR HOWE: I think I need to get some public speaking training; I wasn't expecting this. On the wholesale discounts, I actually came here today to make a couple of points, but I think State Water and DNR have made them all for me in their presentations.

For example, I think it was Peter Sutherland, who was asked why is there a factor of 3 times difference in price between regulated and unregulated? The answer was the existence of large private corporations. I think that is only an example of about 10, but on that score, our position is that we do not really want to have huge differentials in pricing. What we want, if that is introduced, is that it be the subject of a strong, technical and comprehensive study to address cross-subsidies inside valleys. If such a study were done,

we would be prepared to accept the results of that study

MS McLEOD: I agree with John Howe. Wholesale discounts is a significant issue. Both State Water and DNR have tended to approach the question of whether they had them or not from the point of view of the services we provide State Water and DNR.

I think there is a much broader question here in terms of what are the things that they do that are actually not particularly relevant to our organisations because of the scale of our organisations and the things that we do? I think a good example is the WALs, the access licences, the works approval and the requirements of the irrigation corporations to actually handle, on a very large scale, all the issues internally. If you had five irrigation corporations in the Murray, you would not have to have the degree of sophistication that you have to go through your whole WAL process; because of the economies of scale, it could be a lot simpler.

It is a really big question. It may be not necessarily the issue that is to be addressed as a wholesale discount the way it has been, but we need to debate the issue and expose what it is that they do, what we do, where are the economies of scale, where are the things they do that actually are not relevant to the irrigation corporations that impose significant costs on them?

MR REID: Doug, you indicated that the Irrigators Council supported the move to full cost recovery on the basis that both State Water and the Department of Natural Resources worked at an efficient cost level. Do you have any issues with the way that that upper bound full cost recovery has been defined within the submissions of State Water and DNR?

MR MIELL: I suppose that is a case of going back to the definitions in the National Water Initiative, and we would say that the lower bound pricing where you pull that apart provides for the recovery of operational expenses, administration expenses, depreciation, rates of return, dividends, et cetera.

We then see that pretty much everything is in lower bound pricing and it comes as a profitable business. They have been able to either plan or invest in the future or pay dividends out, so they have made a choice of what to do with surplus profits or surplus funds. We then see upper bound pricing as simply another layer of cream on the cake and say simply that that should not be allowed until full contestability is introduced into the marketplace, perhaps privatisation of some or all of the services, so that those who are paying the bill can have absolute confidence that each and every aspect of the operations of both DNR and State Water have been exposed to the maximum extent of competition that is available.

So it is a thorny issue and it comes back to should these assets, which were never designed and perhaps in most instances never built to generate a profit, are now being turned to having an expectation of a profit, dividend aspect of government, so that is a key issue that we have a high degree of opposition to.

MR COX: Do you have any thoughts on State Water's proposal to move into the new regulatory asset base, or is that something you would prefer --

MR MIELL: It is something we would prefer. The issues we have got - perhaps we have the line in the sand issue. So what does it actually do for assets? IPART itself made the determination pre-1997 that it should not have been included in the rate of return, et cetera. So there's the whole issue of how do we resolve the tensions around that particular aspect of it. Is it the best regulatory asset base and constructed in the most relevant way? I don't think the submissions explore the other options. If that were to be considered as a way to go forward, is it the best structure possible, are there other structures that give recognition that there has been long held, since 1997, line in the sand principle where it has just been assumed that that can be extinguished without a hell of lot of debate. So those issues we will certainly explore in depth, but it goes to the heart of the key issue we have got to look at, the line in the sand and is it the best regulatory asset base proposition that is being proposed.

THE CHAIRMAN: I must ask a two-part question. Quite a lot of reference has been made to enhanced entitlements that irrigators now have under the new system in terms of property rights, et cetera. I think I am paraphrasing you correctly, Doug, when you said that if the price increases that seem to flow from the submissions were implemented, I

think you said that licence holders would not be able to exercise these entitlements. My first question is could you enlarge on that a bit? Secondly, reference has also been made to how expectations about trading in water entitlements in the future and the expectations that that will increase that trade and the market will increase. I suppose I am interested in the possibility that, at least in a year of scarce water, the traded price might exceed the price that's determined by IPART and I wondered if you had any reflections on that.

MR MIELL: I suppose on the first question we are simply saying if you look at the unconstrained prices table State Water published, if those prices were to be implemented we would be saying that it will probably price some irrigators simply out of the market. The returns that they could get from their operations, be it today, or as efficiently as they could run it based on the commodity prices and the whole terms of trade issue, will probably preclude them from making an economic decision to actually produce. Therefore, we say that without a full exploration of the basis for all those costs, et cetera, it will limit their ability to exercise the privileges which is the use of the property right that they have got.

With respect to the price of water, well, I suppose the drought issue, or the scarcity of water, that's the market price. The market will put its price on the water that is available depending on the underlying commodity or the underlying use that is going to be applied to, which I am not sure has that much relevance to whatever price IPART puts on, because that will be factored into the end price, and will be one of the considerations that the market will take into account, what is the delivery cost of the fixed and variables. That's the starting point. Then I suppose there's the cost of operations, the extraction cost, the cost of applying it to whatever use it is going to be applied to, and then obviously the market outlook for whatever the commodity is - they are all factors of that decision as to what the ultimate price will be, and of course it could differ from one end of the system to the other and from one end of the state to the other, as we have seen with the variability of the weather in the last three or four years and the availability of water and indeed from coastal to inland. There are too many variables for me to say that it will reflect on the IPART price. That is just one of them.

THE CHAIRMAN: I think we might break for lunch now. We will give the audience an opportunity to comment and ask questions when we resume.

LUNCHEON ADJOURNMENT

UPON RESUMPTION

THE CHAIRMAN: As we have indicated, the floor is now open for the next half hour or so to the public to raise issues, make comments, ask questions. Then we will call on the department and State Water to respond following the public session.

STATEMENTS AND QUESTIONS FROM THE PUBLIC

MR CLEMENTS: John Clements, Namoi Water. I have a question on process. I was involved in this a few years ago and have come back to it recently. The changes that I think I have seen and I will put to you is that increasingly policy decisions are slipping into this process with no debate elsewhere. We see today we have got a debate on the floor about externalities, which is really what it became. What is your relationship to government in terms of setting policy and what is your response to government for policy that is brand new that suddenly gets delivered to you?

THE CHAIRMAN: I will answer that straight away because it is not directed to the water authorities.

MR CLEMENTS: No, it is not.

THE CHAIRMAN: We are not involved in setting government policy. I can think of different types - it has nothing to do with this inquiry - where we have been asked to advise government on policy. The most recent one - and I think the final report will be released shortly - is on the structure of the Sydney Water industry. This is urban water, and we did have a draft report out. That was a policy reference. We only make recommendations. As a general rule, we are not involved in policy. As a regulator we have to implement government policy. Having said that, if the government sets particular policy parameters, for example --

MR CLEMENTS: Externality --

THE CHAIRMAN: If they decide they want to restore river flows, for example, so that there is less water available for irrigation, then we would have to take account of that in reaching our price determination. So we live within government policy, but we do not set the government policy.

MR MURRAY: Murray from the Gwydir Valley Irrigators Association at Moree. I take it this is an opportunity to put questions on the table and they are not going to be answered straight away.

THE CHAIRMAN: They will be answered in the next half an hour. We will take all the questions first.

MR MURRAY: I want to make a couple of points on both DNR and State Water first. I will start with State Water first. The irrigation industry was very supportive of State Water being corporatised and hoping that would create a much more commercial focus. We have been disappointed with the first 16 months performance, with one glaring example of that performance slipping up. There is possibly an explanation for this, but it also points out that they haven't followed their commercial role. For 16 months our irrigators, who were used to receiving quarterly bills, didn't receive any bills. How does any commercial organisation operate for 16 months without inflow? Where is the focus there?

Of particular concern with their submission, and it really impacts very hard on the Gwydir, is the move to go to one standard deviation below average use for their planning base. The concept of average is, obviously, things go up and things go down. Within the submission State Water say, "We can't get as much as we used to get in the past on the highs because of the water sharing plans, yet we are still exposed to the lows." In Gwydir, within individual years, the water sharing plan, allows you actually to extract more water not less. Over a long term average, yes, there is a reduction but in individual years there is a capacity to go for more rather than less.

So I put it to you that over the last three years, last considered the worst drought in the last 100 years, our average extractions in the Gwydir over that period of time were still greater than one standard deviation less. So I really can't see the justification. If you look over the last 20 years, average extractions have matched virtually the average model extractions shown in the submission. I think our average is 300,000ML and the model might show 309,000ML, so that is something that IPART has to look at carefully.

Service level agreements is another area I want you guys to look at. Hydrometrics - it is a bit hard to work out the numbers. I'm not sure whether they have gone from about 2.1 million to over 4 million or just over 5 million. They seem to bounce around in some of the submissions, but the point is how, where we have been paying for the supposed efficient costs these services in the past, can that increase be justified in any way, shape or form.

Now the State Water is corporatised, and State Water delivers an awful lot to customers who don't pay. In the Gwydir we have an environmental contingency allowance, which is an allowance of 45,000ML stored in Copeton Dam. It has got to be delivered. When DNR, who are the managers of that account, say it has to be delivered, it has to be delivered at a certain rate. It has all the characteristics of a general security licence. Is there any reason why State Water can't bill DNR for the delivery of that water at the same rate they charge for general security water?

In a similar vein, with replenishment flow stock and domestic flows, there's a whole range of flows that have to be delivered by State Water when they are audited. They are not things that just happen. They actually have to be managed. Why shouldn't they be charged and paid for? There are numerous other issues and I've raised them in my submission, so I won't go through them now.

On the DNR side of things, I'm certainly no whiz when it comes to an Excel spreadsheet and I could easily lose $2.1m myself one way or another, but what really concerns me is that, in the submission, they talk about an extra six staff members per region, and then today we heard three. That to me means that this project was all done on a desktop and someone said, "Well, we don't have $2.1m, so we'll split it up and we'll lose three staff." It doesn't seem to me that there has been a lot of effort put into making sure that the resources required actually match the demand out there. I think that's something that you guys again need to have a good, hard look at as you go through it.

The other issue, the cost to user shares, again, I think this may be a case of technology and the old "copy and paste" function on computers. We seem to have gone to

100 per cent user share, 100 per cent user share, repeated, repeated, repeated. It appears to me that basically DNR have gone through and said, "What can we rebadge as a new activity, what can we blame on National Water Initiative, and we'll just make it 100 per cent user share." In particular, that concerns areas with the water sharing plans.

I think we have to basically state that these water sharing plans were again a line in the sand. This is what the shares are now. If we're going to change those, the people who benefit from those changes are the ones who should have to wear the cost, not the irrigators, not 100 per cent. Now, if I were a real optimist and thought the water sharing plans would change in favour of irrigators, that would be great, but they are probably going to go against irrigators if any changes are made. Who's the beneficiary from that, the community at large, and therefore they are the people who should be paying for it.

They are a number of issues that I think really need to be addressed. Thank you for your time.

MR DOYLE: My name is Bob Doyle. I am chair of the Coastal Valleys Customer Service Committee, and specifically I'm there as a rep from the Paterson River. A few comments were made about the North Coast and South Coast, and on the coast in particular we do have major problems in achieving cost recovery. I just want to make a couple of comments on the two-part tariff. The Irrigation Council is pushing for a high percentage of usage as part of the two-part tariff. On the coast it is basically our preference for 60 per cent fix, 40 per cent usage. The aim of that is to give the best signal to all stakeholders.

One of the problems we have on the coast is we have plenty of water, which is something the inland rivers don't have, in the main. It's a little bit different on the South Coast. We tend to get 100 per cent allocation. Our problem is we don't have a high usage. We have a lot of sleeper licences, and that water has to be stored for those sleeper licences, and if we go to a high usage path tariff, those sleeper licences basically get a free ride.

Now, on the western rivers there's an opportunity for temporary trading. That temporary trading just doesn't

occur on the coast anywhere near in the same way it does on the inland rivers. So, in terms of sending the signal to all the stakeholders, the irrigators, to State Water, to be more efficient and to best use the water resource, we differ in the basic view that has been taken by State Water on fixed versus usage, and we particularly differ with the Irrigation Council's basic move.

There is a specific problem with the North Coast and the South Coast that has to be addressed in its own right, and the Paterson River, which at the moment is lumped in with the Hunter, falls into that same category. At the moment the Paterson is heavily subsidised by the Hunter River itself. So it needs to be included basically in the same sort of category as North Coast and South Coast.

MR HECKENDORF: Thank you, Mr Chairman. Rel Heckendorf from Murrumbidgee Private Irrigators. With regard to State Water, Tony Wright mentioned earlier that there has been substantial cross-subsidisation between valleys, and I understand that the subsidisation has probably come from the Murray and Murrumbidgee. We would like subsidies to be returned, because we have been at full cost recovery and that money has been used in other valleys. I don't have a problem with that, as long as it comes back. I think it's been driven by the lack of government contribution in its IPART obligations to pay their share of water charges. It's a matter of duckshoving money from here to there all over the place. We would like some reconciliation of that, where those moneys have gone and what moneys haven't been put in by the government in its share.

I have some difficulty with the changing of usage from a 30 per cent usage charge to 60 per cent. A lot of the charges we pay are for the integrity of the system, and the integrity of the system is also part and parcel of the capital value of licences and allocations. Now, I think that needs to be recognised.

I have a bit of a problem with some of the capex figures that are based on subjective information generated by computers in depreciation values. I'll give you just one example. Berembed Weir, for instance, has been there about 100 years. The last time I saw it, it had one hairline crack in it, after 100 years of being part of the system. From my perspective, all these structures should be visually assessed rather than subjectively assessed by a computer system and then capital expenditure based on that.

I'm also concerned that it has taken three years before State Water achieves efficiency. Most other people in commercial operations have to achieve efficiency, and achieve efficiency now.

From DNR's point of view, I can't understand it where they get the value from water reforms and attribute that to irrigators. If there was a high value on water reforms and legal entitlements, et cetera, then that ought to be reflected in the market value of licences. Market value of licences hasn't changed significantly, and in some cases it's gone down. So those water reforms have no value whatsoever, to my way of thinking.

The other thing is we have also got a cost involved now where shire councils are going to charge a levy on council rates based on works approval. So that's another impost on water reforms. I'm bewildered by the duty of care. Generally speaking, duty of care has two edges to it. I'm bewildered by what, if something goes wrong, the department is going to do, if they expect us to pay for that duty of care.

Hydrometrics is another one that I find difficult to understand. We have just got the account in Murrumbidgee for hydrometrics and it works out at basically about $60,000 per station, which is absolutely ludicrous. These stations are not that complex. Thank you, Mr Chairman.

MR MORGAN: Thank you, Mr Chairman. Ted Morgan from Lachlan Valley Water and Jemalong Irrigation. I just wanted to make three points with regard to State Water. Firstly, I object, and Lachlan Valley Water objects, totally to the government handing what is in fact a non-business-ready entity over to State Water and then saying to the irrigators, "There's a dead duck there, but you people have got to pay to bring it back to life."

I don't think it's at all reasonable that costs that are being put in to establish a business are going to be levied against the irrigators. We've been through it in privatisation years ago where, when you hand over something, the government should hand it over and finance it to the extent that when you're up and running you have a

going concern, you don't have something that you're meant to be financing through the users in that way.

Secondly, I believe that if State Water is unable to demonstrate flexibility required in low water use years and in circumstances that mean that the user and the payer should be recognised as in extremely difficult circumstances, if they are unable to deal with the issues in terms of costs in there, it should be a transparent subsidy, and that transparent subsidy should be reflected in the way that the charges are levied. The government acknowledges that, because of policies that are government policies, there are costs that are associated with it that should be the cost of government.

Thirdly, to use the one standard deviation below what is the average use and then apply that to the pricing in the Lachlan adds about $1.5m to the cost of the water, but what you have is a corporation that says it wants to be commercial, wants to sheet home commerciality in whatever way it can, and yet what it does is say, "No, we're not going to take any risk, we're not that commercial. What we're going to do is we're going to collect all the money we can to make sure we have no risk." That's all very well for their shareholders, but it's not any good at all for their customers and those who are going to be trying to produce feed and fibre, and so on.

To the DNR, I just wanted to touch on the duty of care as well. This has been touched on, but I think it's of such concern to all of us that it probably needs reiterating. I'll just quote from our submission:

DNR's central proposition is that under the new system of water entitlements licence holders have a primary duty of care obligation to meet the agreed environmental objectives as set out in the water sharing plans, thus protecting their access rights to water. (Page 24 of the DNR submission).

This is like saying that taxpayers have a duty of care, have a duty to achieve government budgetary outcomes rather than a duty to pay the tax as provided under the legislation. So not only do you have them drawing what's a fairly false sort of analogy about why we should be paying for it, but, worse still, nobody knows exactly what the environmental outcomes are that are required, nobody can actually quantify them. As Rel has said, what happens if they decide they haven't quantified them? Thank you very much.

MS McLEOD: Jenny McLeod from Murray Irrigation. I just want to make a few key points and not have an extensive discussion. The first point I'd like to make is that this pricing determination is very, very significant in terms of if the requests of DNR and State Water are met on the impact on customers in the Murray Valley in New South Wales, and I think some of the propositions that are coming from State Water and DNR really challenge the progress that has been made through the IPART process about really defining what is full cost recovery.

We've heard today a lot of comments about we support full cost recovery, but I think IPART would realise that it's not a straightforward concept, and we will be providing our views about that issue. But I think this whole question of the regulatory asset base and the question of is government policy for State Water to pay them a dividend, the way I see it you could basically set your regulatory asset base to create whatever revenue stream you want, and I think that's a very significant issue that IPART is going to have to deal with.

The next issue I'd like to raise is disclosure of costs. For irrigators and customers to provide really constructive input into IPART, we need much better and more detailed information about actual costs and the outcomes received from them and then expected costs, and what better outcomes do we expect to result from those increased costs that have been proposed. I don't think we have got to that point with what's been provided to us today.

The next issue that is very relevant in the Murray is MDBC costs seem to be a major driver of potential increases in price. Is the same scrutiny going to be placed on MDBC costs? Where is New South Wales in terms of arguing about some of the principles they've agreed to through the MDBC? There would appear to be quite a divergent price path between Murray and Murrumbidgee costs, largely driven by the MDBC costs, and we want to explore that issue.

The third point that I wish to make relates to the Murray as well, and it's about the institutional structure.

We have a structure in the Murray where we have MDBC, we have DNR, we have State Water and we now have catchment management authorities, and, as customers, it appears that we're actually paying bits and pieces of each of those organisations' costs. It's a very expensive institutional arrangement that has been established by government, and our argument is that we shouldn't be prepared to pay for government's inefficient institutional structure. We also have costs relating to those issues in terms of arguing for our interests as well.

The next issue relates to cost sharing, and in the case of the Murray there are enormous free rider issues and some of the cost drivers aren't related to the water we extract from the river, they relate to the community expectations of the way the river is regulated. I'm talking about things like opportunity to provide variability in flow heights along regulators and to provide more efficient mechanisms for providing water supply or managing environmental impacts that the community just won't accept. So we have to choose more expensive solutions which irrigators pay for.

The last point I want to make, and it has already been made to a certain extent, and actually one of Michael's questions was about this issue, is we need to reconcile what irrigators already paid for, what State Water and DNR have actually spent and where are their differences, and what's happened to the annuity we have been contributing for a large number of years? Where has it gone? If State Water were a private entity, it would either be spent or it would be sitting there waiting to be spent in the future.

MR HOWE: John Howe from Murrumbidgee Irrigation. I don't want to bore everybody by repeating some things, so I'll just focus on some things that may not have been picked up that much.

The first point is that, under the RAB, and I'm sure the IPART people know the sorts of protections that are required under RABs for customers, when going towards an RAB, as long as we're getting charged appropriately, and the assets reflect the service value, there's no problem. Where you have the opportunity for game playing on the budget side and have massive capex programs built in for the first three years, you do have major problems as to whether the services are reflected in the assets or in a line item budget, and the two are quite different.

The other point - and I suppose this is associated with budgetary game playing as well - is that maybe there is a case for going to a 10-year IPART horizon because, with basically every determination, we get these massive price hikes requested by the entities and they scare everybody. If they were to come to pass, we would have major structural adjustments associated with them, but IPART comes in and says, "No, it is 50 per cent below that." That is quite good for us, but if we could reduce this process of having to argue these transaction costs each time down to a 10-year determination, that would probably be good. We could just focus on small changes to it then.

In relation to the efficiency benchmarking, a point that Peter Sutherland made was very valid - that you need to take into account the institutional arrangements when making comparisons with Victoria, Queensland and South Australia. None of those states have very large private irrigation companies and these companies act to significantly reduce costs.

I am sorry, I did have another question, but I think I will have to leave it there, thank you

MR PARBERY: Thank you Mr Chairman. My name is Richard Parbery. I am Deputy Chairman of Bega Cheese and a practising accountant. I am very involved in the rural industries. State Water forgot the South Coast. When Abel Immaraj put up his averages, we were left out. For us the average cost increase would be quite frightening. Bega Co-op has 100 suppliers and the whole area is totally dependent on it.

I spoke to Jim Cox before lunch and actually requested that we could put up a separate submission at one of the regional hearings, because our situation is quite peculiar compared with everything else that has been going on today.

These are said to be the corporation's objectives:

The principal objectives of the corporation are to capture, store and release water in an efficient, effective safe and responsible manner; to exhibit a sense of

responsibility towards regional development and decentralisation in a way in which it operates.

From the South Coast's point of view, we believe this will destroy our regional development and decimate the economy in the Bega valleys. We do request the right to resubmit or put forward a submission at one of the regionals. We have 500 employees in Bega. Our farmers employ 300 to 400 employees, and the whole of the economy of that valley is dependent on Bega Cheese.

It is amazing how we differ. We actually have a 40 per cent fixed and 60 per cent variable, which would be part of our submission, basically because now our usage will be very low with much of that water going to environmental flows.

MR ANTHONY: My name is David Anthony. I am with Auscot and we have irrigation in several valleys. We have put in a submission. One of our biggest concerns relates to what costs we as irrigators will wear that should not really be apportioned to us. That question was raised in several of the presentations today.

Let us look at our Macquarie Valley operation, where we have the Macquarie Marshes down at the bottom end of the irrigation areas. If we go back to some of the comments that were made about wanting to have some environmental outcomes and our meeting the cost of that through the water channels and that there will be some costs to go towards that, what do we do when we look at places like Macquarie Marshes? There is more and more evidence coming out today that it is not the irrigation industry that has been the cause of much of its problems; it is actually grazing where State Water is not getting income from those people - fat cattle and fat duck syndrome. We are really concerned about this. We want to see some greater transparency in how the water charges go so we do not get picked on to pay for a problem that may not be of our own making. That is a great concern.

If you look at the Gwydir, there is also the same issue up. There are issues with the wetlands, where we obviously want to do some repairs. I think the community wants to make sure those places are maintained, but it seems like a lot of decisions are being made on wrong grounds. I just fear the irrigators will be paying for that out of their water fees.

MS KERR: My name is Deb Kerr. I am from the Rice Growers Association. My apologies for not being present this morning. I had previous commitment in Sydney. I want to reiterate some of the points that have been made earlier and support the comments that have been made.

In particular, a big issue I believe is the MDBC River Murray water costs. I am a member of the Murray Lower Darling Customer Service Committee and we have been provided with some information on those costs as well as through the IPART process. Quite frankly, the two do not even match up.

I am imploring IPART to really take a good hard look at those costs and at the principles on which they have been allocated to New South Wales and then how we look at IPART pricing within New South Wales. They are two different processes, they are done two different ways and the association does not think that using MDBC costs, which are allocated on average usage which includes a third of South Australia dilution flows, is an equitable way to charge New South Wales irrigators. I would really encourage you to take a strong look at how this is done.

The other comment I would like to make is that within both the DNR and State Water Corporation submissions, one is unable to actually pick out what costs are attributable to Murray Valley, to Murrumbidgee Valley, both for DNR and MDBC, in their submission, and for State Water and River Murray Water in the State Water submission. It is really not very transparent.

MR HOWE: Actually that has reminded me of the issue that I was going to mention. We agree that the MDBC costs are very superficially dealt with. Again I do not think the correct response to that is the way DNR has done it in its submission. I can't for the life of me really work out how DNR has done it, and the same applies to the State Water submission. If somebody here can answer that question, it would be good. So I actually agree. It may even be favouring Murrumbidgee somewhat at the moment, I am not sure, but once again, as with all these cross-subsidy issues, we believe they should be dealt with fairly comprehensively, transparently and clearly for customers.

Another issue in relation to that that I would raise is whether government departments really should be encouraged to use a RAB technique at all. They are hardly commercial, really. The fact that we are paying externality charges to them is one thing, but to actually use MEERA values to come up with assets and then call that a RAB and charge for it, I think is a bridge too far.

MR MURRAY: I have just a couple of other points that I failed to make earlier. I wanted to raise a question for DNR, but I think it is one that State Water need to think about as well. If we look at DNR's submissions, it wants to have 311 staff doing water resource management and State Water would like 310. I would like to know why it takes one more person to regulate and audit the operations of an organisation that has to do all the delivery, ordering and billing. It just seems to me outrageous that, if you like, the bureaucrats outnumber the people on the ground doing the job.

In terms of just giving people a comparison as to what sorts of price increases are being sought, I ran through the numbers for the Gwydir Valley using average extractions. If you looked at what IPART determined in its last determination for 2005-2006, at average extractions, the revenue in the Gwydir Valley would be $2.54m. If you look at what State Water asked for last year - not what was determined, but what they were looking for - and if that had been applied, they would have got $2.93m.

If you look at what State Water is asking for this time around and you apply those average use figures, we see that State Water is after $6.45m. That is a huge 253 per cent increase. I just cannot see how that could be justified at all.

IPART has mentioned that it would like special consideration of high security, general security premiums. The Gwydir Valley Irrigators Association fully supports the concept of the high security premium fully reflecting the extra costs of storing high security. We just happen to believe, thought, that the formula that State Water has applied is wrong. It certainly does not work in the Gwydir scenario where instead of having to store two years supply, they have to store 18 months supply.

We have no conversion factor for high security to general security in the water sharing plan. That's something that is meant to be done, but it is not there yet, so I'm not sure where they pulled the figure from, and it seems to fail to take into account that the general security people actually have 150 per cent share of the dam space for their entitlement. So while you might be storing high security water for two years, general security water has to have the capacity to store 150 per cent of entitlement.

I think what needs to be done there is for State Water to work out on a valley-by-valley basis what is the fair and reasonable way of doing this, take it back to their customer service committees, get it kicked around a little bit, and come back with a recommendation for you guys that really meets the individual nature of each valley.

THE CHAIRMAN: This might be the last question.

MR CLEMENTS: I have a question for State Water: as a general question, do they have a policy on evaluating the costs of legacy infrastructure decisions, the impacts of those decisions on operating and capital expense costs; and with reference to the Peel, could they comment on that?

THE CHAIRMAN: I think, given the time I would like now to call on State Water to respond to those comments and questions.

RESPONSE FROM STATE WATER

MR IMMARAJ: Mr Chairman, I think I have noted most of the questions, but I will be passing the microphone to the others as well.

Just starting with the last question from John Clements, with regard to the policy on the legacy issue, that is not an internal policy matter but more a policy that will be driven through the IPART determination, as was the case in the last determination that dealt with legacy costs. So we do not have a policy with regard to how legacy assets, in particular for the Peel, should be dealt with.

MR CLEMENTS: And IPART has confirmed they do not make policy.

THE CHAIRMAN: There is a regulatory policy in that case, where an asset is, for whatever reason, no longer useful and that is deducted from the regulatory base, if that is what you are referring to.

MR CLEMENTS: It is the impact of an inefficient structure, a legacy decision that has led to an inefficient structure which can never have efficient operating costs. Is there a policy on this?

THE CHAIRMAN: In principle, the regulatory policy in that case is that we are looking for what it would cost to deliver water if it was delivered efficiently.

MR IMMARAJ: Turning to Michael Murray's question and, first of all, his comment with regard to not having received his bills: there have been some changes to the systems especially with the issuing of new licences. We are now on the verge of fixing up most of those problems. I believe that most of the bills have gone out except for the quantity billing ones which have a unique issue called the parent-child relationship between the old licence and the new licence. So, trust me, you will get your bill.

MR MURRAY: Don't wait.

MR IMMARAJ: With regard to the one standard deviation below the average usage, you are right; it is a risk minimisation position that we have taken with that one standard deviation. It does have different bearing on each of the valleys, but one standard deviation being a statistical factor, it does end up with different numbers in each of the valleys. So even if you looked at half a standard deviation in each valley, it would result in the same level of risk mitigation.

One standard deviation has different implications for each valley. In the more secure ones - for example, the Murray and the Murrumbidgee the standard deviation is much lower in absolute terms than, say, in the Lachlan or the Macquarie, which tend to be the most.

The main driver is not so much risk mitigation per se, but if you move from the current fixed variable ratio of 70:30 to a 40 fixed and 60 variable, that is where the big hit comes in, which is why we have to look for some risk mitigation. You are right - if every year was fixed at a 70:30, then we would not need to mitigate our risk through a standard deviation, but that is now being debated through IPART, so there will be some further discussion on that.

With regard to the hydrometric costs, as we indicated this morning, it is not open to competition. It is not some asset that we can put on the market and say, "Can somebody purchase this asset and run it more efficiently?" We are compelled to use DNR as the service provider in that instance and we are working with them through this benchmarking process that DNR talked about this morning to see if there can be efficiency gains in that.

Whether environment flows can be charged or not is really a matter that will be resolved through this pricing determination. It may not be directly to the environmental agency, but it may be just through a government subsidy or a government cost share. So that is something that is yet to be resolved. We cannot arbitrarily send a bill out to the environmental customer. We cannot arbitrarily send bills out to replenishment flows or basic right holders. They all rely on a determination that helps us to get to that point.

Turning to the high security general security conversion, I would suggest that, at some stage, if you would like to spend some time with Dan, he can explain how that high security general security premium was arrived. It is different in each of the valleys depending on what

the actual storage is and what the water sharing plan conversion factor is.

Where there is no water sharing plan in place, we have used the IQQM modelling data to tell us what the premium should be. So it gives us an indication as to what would be the normal general security allocation even though there is no water sharing plan in place.

Certainly the questions for the North Coast, the South Coast and the Hunter are quite different from the rest of the state. If there is a different fixed variable ratio set for different valleys, we will accept that. It may mean a different level of risk management for us in terms of revenue implications, but we do understand that, ultimately, that fixed variable ratio is a driver set by our operating licence and in compliance with the operating licence, that is what we have sought.

We had two choices - one was to go to a global cost-sharing basis as a 40 per cent fixed and 60 per cent variable, or individually work out different ratios in each valley, a combination of which would still meet the obligations under the operating licence. We chose the former, which was a much easier option, but if IPART decides to head down that path of variable ratios in each valley, then we will attempt to get there.

We do recognise the Paterson and the implications of the Paterson being treated differently or being lumped in with the Hunter. While we have not addressed it in the submission to IPART, once the water sharing plan for the Paterson and the rules are defined, that will give us the basis on which we can go to IPART.

Rel Heckendorf asked a question with regard to the cross-subsidies and whether the government contributions were, in fact, the reason for the cross-subsidies coming in in the first place. Most of the information that predates 2004 is not in our hands, so we cannot really analyse that information to say what happened to the government contributions that might have come in to our parent body, but there are issues that jointly between DNR and State Water need to be decided.

With regard to the user charge being raised from 30 per cent to 60 per cent not being supported, as I said, we do not have a choice in this matter as far as what we must seek is in accordance with the operating licence, but the operating licence does not specify that split; it simply leaves that in IPART's determination to be made.

With regard to Berembed Weir, while I understand your concerns with regard to whether our assessment of the condition is too conservative, there are government asset management guidelines that we must adhere to, and the portfolio minister's requirement through the operating licence is that the assets must be protected. It is not an arbitrary decision that we can make based on a visual assessment only, but the condition assessments and audits must be done in compliance with the government's guidelines. That does mean that we do check to see whether there are variations based on the need of the asset and the service levels of that particular asset, and we will negotiate whether those service levels are adequate for the customers and whether the service levels are surplus to requirements. That means we can deal with that new asset or existing asset in a different way.

In our estimation at the moment we have estimated it will take us three years to get to that point of starting to realise the efficiencies. We are working very hard to try to get to that point, but there is significant investment that is needed to get to that point. We have had to put in our own financial system. As you know, every IPART determination until now, one of the key points that has been made is financial information must reside with the State Water's financial system. We have rolled that system out in record time. It took us six months from the time of making the determination of getting a new system to rolling it out, and we were working hard to ensure that that information is provided. So some of these basic systems that are needed to achieve those efficiencies are what we are working on.

The MJA report that Doug referred to this morning talks very clearly about all these systems and processes that State Water must have. Those guys have done a lot of reviews on all sorts of SOX, and the first thing they pointed out is that State Water needs to have these systems in place, so we have embarked on making sure those things are in place.

As to hydrometric charges, we are concerned with

regard to what exactly are we being charged for. There is quite a lot of debate going on between DNR as the service provider and ourselves to make sure we are getting value for money. If we are convinced we are not then we will be renegotiating those contracts on that basis.

MR SIMONS: Can I add to that that someone made a comment that they believe the charges per station was about $60,000 per annum. I know in one submission that that cost is significantly less by streets. You would find in our submission that it is about $13,000 per station which according to the MJA Cardno report last year is about the right figure.

MR IMMARAJ: We did discuss this with regard to which stations actually should be in the bulk water delivery boundary as against all the stations in the Murrumbidgee, so the $60,000 came from dividing the total cost by the number of stations requiring bulk water delivery.

Ted Morgan's questions with regard to business not ready organisation being handed to the irrigators to be managed, that is something that will be played out through the IPART determination with regard to cost shares, and once ultimately the prices are set that will result in some discussions with the government with regard to subsidies. So while we have put the full costs in there, and it is our duty to put the full costs on the table, it will be the determination that will drive who pays for what.

On our flexibility for low water use, a few of the submissions from our customers themselves point out that State Water is largely a fixed cost business. Therefore, that obviously means that our flexibility in low water years will cover the cost of services was, heaven forbid, the running down of assets. So I think if it is to be a transparent subsidy, it also needs to be made through a determination process. Once again we don't necessarily want to be subsidising amongst valleys unless the prices are clearly set.

One standard deviation, again I think we have answered that. Just by way of more information, we have put fact sheets on each of these questions on our web site which gives you the background to why we have adopted the one standard deviation and what level of risk mitigation there is for us. We recognise that in some valleys there will be a bigger implication than others.

John Howe from Murrumbidgee Irrigation raised the question of the regulatory asset base and its impact on consumers. I guess I am quite happy to take you through the regulatory asset base approach. It is no less unfair or no more fairer than an annuity approach when it boils down. It is far more transparent in the way it can be applied and accounted for, so there are distinct advantages in going to regulatory asset based.

I draw attention to all the metropolitan water utilities as well as the bulk water utilities across the state have adopted the regulatory asset base approach. The main flexibility in the regulatory asset base approach is you are planing on a three-year time frame, and a three-year time frame is far easier to predict than an annuity based on a 30-year or 100-year plan. Murray-Darling Basin Commission has a 100-year total asset management plan with capex factored in and an annuity calculated on that basis. It locks them into positions that they perhaps should be revising every three to five years, whereas the regulatory asset base, which again is regulated by IPART, is a good way for the customers to keep track of what exactly is being done - and that was one of the questions raised by Murray Irrigation - but also in terms of having an independent body capitalising what is prudent and efficient. Even though we might have spent the money, if IPART is not convinced it is prudent and efficient, it doesn't get capitalised, so you don't pay a rate of return on something that is not prudent or efficient.

The MEERA value was estimated using engineering equipment, and that was the $2.3 billion. That has no bearing on the regulatory asset base. The regulatory asset base is calculated on the earnings potential of the assets. So the return on assets was not imposed on the MEERA value but only on the customer share of the regulatory asset base. They were the figures that I put up for each valley saying in each of the valleys this is the regulatory asset base attributed to customers and the rate of return of 7 per cent, which is what we have proposed, be applied on to that customer regulatory asset base. Even though the rate of return is something that the determination will determine; it is not something that we simply adopt and move forward on.

MR SIMONS: State Water itself had quite robust discussions on the level of what the regulatory asset base should be as a starting point. So it is not a figure that has been simply plucked out of the air that seems to be suggested in some cases, but there is some quite robust discussions behind that.

MR IMMARAJ: As to the question of bulk water discounts for the larger irrigation corporations, once again the reason that we proposed for these to be removed is that we no longer see the need for a discount because there is no efficiency of scale associated with those costs. We are driven to a large extent in our operations and in our asset management and in our customer service by the large corporations. When the large corporation sneezes everyone in the valley catches a cold because they are so much smaller compared to larger irrigation corporations.

A 5 per cent variation in the large irrigation corporations water audit has implications for over 500 customers on the main river so we have to work extremely hard in dealing with the relationship between the large irrigation companies and State Water. Consumption of assets, which is a large part of our costing, is therefore not an issue of economy of scale but in fact is driven by the scale of usage, so if, however, any of those pre-existing requirements for the discount still exist, we are more than happy to sit down and discuss how we should reimburse the irrigation companies for information that they might be providing to us or information that we need to purchase from you. When we have to purchase water from the irrigation companies to supply our own customers at the bottom end of those companies, we do pay the going rate. So we fail to see why we should be extending those discounts.

The customer service committees have asked for clarification where there is a true discount or a cross-subsidy from the main river pumpers to the irrigation companies, because if the net total cost for the valley is fixed, a discount for the big irrigation companies comes at the expense of the other users in the river, but that is an equity issue that IPART will be looking at.

Richard from Bega Cheese - I do apologise, I couldn't write down the numbers for your prices; I ran out of room on the page. We had to put the information out. It was our duty to put the information on the table as to what it costs us to run the dams in terms of operating expenditure and the capital expenditure. Once we put that, we ran it through the models to see what it does to the prices. We put those unconstrained prices up there.

Having said all that we are very much concerned about the impact that is has on the valley, and we have been in discussions with the government and with IPART as to what this means. Obviously the determination is going to make a government subsidy either a requirement or we need to start talking to you about reducing our opex and capex in those valleys to meet your revenue base. We understand that 40/60 would be more appropriate to the valley and that is something that we can consider as a specific case for the Brogo system.

With regard to the Murray Darling Basin Commission and the River Murray water costs, in terms of how the apportionment of the costs works is quite complicated. The costs attributable to the Murray, or any of the valleys, is clear in our volume 2, if you go to appendix 10, the breakdown of the opex, the capex, the return of assets and the return on assets is identified year by year for each of those valleys, so if you still have any further questions within that, we are quite happy to sit down and explain that to you. Because the Murray is treated as a continuous system from the head works all the way to the barrages, the NSW customers do pick up a portion of the NSW share of the full cost for that system.

MR SIMONS: To further answer your question there, Deb, I think you were asking as to what portion of River Murray water costs were allocated to the Murray customers. All of it.

MR IMMARAJ: If I may add a point in relation to this morning's presentation from the Irrigators Council, the lower bound pricing and the upper bound pricing need to be reviewed fairly carefully, because what Doug also mentioned this morning is that the lower bound pricing does allow for the operating expenditure and the return on assets and also specifies a dividend.

To me that is actually more unfair than an upper bound pricing which simply says that all you are allowed to

recover is your operating cost, a return on asset and a return off asset - full stop. So you can go explicitly with the dividend in the lower bound pricing and get that locked in, and in fact that becomes part of the cost structure which we can't negotiate on, or we pursue to its upper bound pricing, which I think is a lot fairer because there only three costs in there, and in the cost of capital there could be some discussion on what is legitimate for a business of this nature. I offer that.

My limited understanding of the IPART process outcomes is that IPART looks at the cost shares, so no matter what is in the submissions, IPART looks at the cost shares, IPART will determine what the regulatory asset base is no matter what we propose. IPART will set the price, and all we have done is attempt to put the information as best as we can garner on the table, debate it, get submissions and then they will make the determination. So the unconstrained prices are purely that. They are unconstrained by anything that we would like to place or anyone else would like to place.

MR SIMONS: There are a couple of more things to say. Michael, you were talking about the amount of storage in Copeton Dam for the Gwydir. We spoke about this at a previous meeting that we had when you made the statement that we had to store 18 months worth of water in Copeton. We did do a check on that, and I am happy to discuss it with you further, but we did do a check in the water sharing plan and have confirmed it at two years, so that's why we have left it as two years in the submission.

In regard to your extrapolation of costs and revenues, rather than trying to argue that here, I would rather, if I could, take that off site and talk to you about that over the phone. I would be more than happy to do that.

THE CHAIRMAN: Thank you very much. I don't want to reopen the whole thing, but if there is someone who feels that a question wasn't answered, I will give you now the opportunity to ask it again. I will not be asking people to ask the question again if they didn't like the answer.

MR HECKENDORF: I obviously asked the wrong person the wrong question regarding subsidisation. I will ask DNR for the answer. We are still concerned that we have not got proper value for the money that we have put into the

Murrumbidgee Valley. We are concerned that the government has not put its share in, too. We believe it has led to the reduction in the efficiency of the assets.

MR CLEMENTS: If it assists, Abel, the definition you just quoted of lower bound cost recovery, could you let me know where it is from and I will look it up later?

MR IMMARAJ: I forget the page number, but in the last determination from IPART it is one of the footnotes. It might be page 23. It refers to the two definitions of the lower bound and upper bound pricing as per the National Water Initiative. That is where I have taken it from.

MR CLEMENTS: So it is a National Water Initiative definition of lower bound.

MR IMMARAJ: Yes.

MR HOWE: I have asked two questions and you may have become confused in relation to the RAB. When I pointed out that the RAB should not be able to be charged - or method should not be able to be used by government departments, you are not a government department. My issue with the RAB in relation to State Water is that there needs to be certain protections in there for the paying customers. One of those protections that it seems is not there at the moment under the current method is that the RAB is based on budget estimates.

Now, just taking the current SWC submission, the estimates will have the effect, less the depreciation, of lifting the RAB significantly throughout the period. If that investment does not take place, which has been the experience in probably the last 10 years, then we are effectively paying an RAB for paper, and it is very important that an RAB reflect the assets and services for which we are being charged.

MR SIMONS: In the first instance, as to the protection of the consumers, a lot of that protection will come through the opex and capex review that will be done of State Water to ensure that what we are actually putting into our submission is what we would say is prudent and effective expenditure.

The other point to note on that is that for different

types of expenditure, it doesn't necessarily mean that all of that expenditure is going to be borne by extracting users. Quite a lot of that expenditure that is going on over the next few years is for dam safety upgrades, which we have put in our submission as not payable by customers.

MR IMMARAJ: That means any capital expenditure on dam safety say in the Murrumbidgee Valley, we did upgrade Blowering Dam, we spent $10m on that. That $10m of capital, if it is proved inefficient, IPART will allow us to capitalise that on to the government share of the regulatory asset base, not on to the customer share. So the return on the customers' regulatory asset base doesn't go up as a consequence of those dam safety upgrades.

If, however, we agreed to enhance the structure for improving the service delivery to the customers in the Murrumbidgee, and we spent, say, $5m on a particular weir, that $5m would be attributed to the customer's share of the regulatory asset base and the return on assets would then flow on from that. So we have split the investments into the future, the capital investments into the future, into the same streams. So, as you look at the splits now, the proportion of those splits will change over time, depending on what exactly we've been spending. If you haven't spent it, then it doesn't get capitalised.

MR HOWE: So you're saying that if IPART determines pricing now, it is only based on actual expenditure and actual capital to date?

MR SIMONS: No, it would be based on the next three years' budgets. It certainly would be. But then there would be mechanisms that IPART would certainly put in place at the end of the three years to review what we have spent. If we have underspent, then they would be certainly looking at price adjustment mechanisms to account for that under-expenditure, and if we overspend, then it would be up to us to prove that it was prudent and effective, in which case again a price adjustment mechanism would be put into place.

THE CHAIRMAN: I think we might call it a day there.

MS McLEOD: I just want to ask one question. I did raise it in the questions I asked Abel. What's the New South Wales government's policy on State Water paying them a dividend?

MR IMMARAJ: I think Russell would relish the response to this one, so I will get him to answer this one.

MR SIMONS: The policy on dividend is outlined in our SCI. It Is in accordance with the commercial policy framework that's issued by Treasury, and I have to say that in our submission we do not include dividends as part of our water prices.

MR IMMARAJ: So it is not part of your costs. We are not charging the customers for a dividend. The dividend is at the moment a certain percentage of the net operating profit after tax, so it is off the bottom line, rather than as being an input cost. Whereas I think you will see that in the lower bound pricing definition - don't laugh, John, but that is what it says, a dividend --

THE CHAIRMAN: Just to clarify for you, IPART will in its determination, part of it will be to determine the appropriate rate of return on the asset base, and that rate of return would normally be sufficient, as it is with any commercial organisation, for it to pay dividends to its shareholders.

The rate of return is reflected by the assessed risks of the business, in effect. We look at market, market rates, and so on, but capital market generally, a firm which is able to achieve the market rate of return can then pay dividends from the profits consistent with that rate of return. I'm going to ask the Department of Natural Resources to come forward now and answer the questions and comments that are directed to you.

RESPONSE FROM THE DEPARTMENT OF NATURAL RESOURCES

MR SUTHERLAND: What I intend to do is try to pick up as many of the themes that came across in a number of questions and then deal with some of the more specific issues separately with the panel here. I think one of the questions related to the Murray Darling Basin Commission costs. The bulk of the Murray Darling Basin Commission costs really relate to the operation of River Murray water, and those costs are really relevant to State Water's business. DNR has included those in our charges that relate to MDBC matters, such as salt inception.

In terms of the questions relating to the whole issue of duty of care of irrigators, is the environment a customer, I think the important issue here is that the environment isn't seen as a customer in the same way as the irrigation industry. The environment is seen as a community good and most of the activities related to water resource management are there to ensure sustainable operation of the industry within the necessary constraints. As was said, the water sharing plans identify the rules of racing, if you like, in terms of industry in order to protect not only the environment but also the property rights of users. The costs associated with the department's activities related to compliance and enforcement are really determined by the need to ensure that the irrigation sector operates within the principles of duty of care and within the rules of the water sharing plans.

In terms of the number of questions related to the scope of water resource management, and ultimately this will be a matter for IPART to determine on, including the relative cost shares in relation to the various activities under the heading of water resource management, I think the key issue is that the objectives of water resource management, as we said in the presentation, are to promote resource sustainability, to manage the impacts of water extraction on the environment and other users and to protect the integrity of the property rights of all users and to secure access to all users, and to undertake the licensing and consent arrangements.

In terms of the groupings of the activities to achieve those objectives, the categories that have been identified relate to the tasks of, firstly, allocating the water resource through water resource planning, the information base in which to both undertake that planning and to protect the resource, and that includes monitoring and modelling, and activities related to compliance and enforcement, again to ensure the integrity and sustainability of the system is maintained, and, finally, the transactional costs associated with consents and dealings.

I understand in the Irrigation Council submission there's querying about whether in fact water resource management charges should be just confined to, if you like, the audit and regulatory role. We believe the suite of activities is critical to undertaking water resource management to achieve the objectives of sustainability both for industry and the environment. So, again, that will be a matter for IPART to consider.

In terms of the issue about subsidies, our submission doesn't involve any discussion about or any proposals for cross-subsidisation. We have purely identified the costs associated with delivering the services and activities in each region and valley. However, there clearly are issues where the unit costs, as we've seen, vary from valley to valley about IPART, or obviously consider the equity issues associated with that, but certainly the department is not proposing in its submission any forms of the cross-subsidisation.

In terms of the issues to do with the cost sharing, or the share of costs by water users, I refer people to the detailed appendix, but, again, we believe that the sharing arrangements that we have identified can be derived on the basis of principles both under the National Water Initiative and the legislation that we operate under within the state.

They were some of the broader themes that came out of the discussion. There were a few additional more technical questions that we might address.

MR van BUEREN: There are two main themes, I think, that I'd like to expand on that Peter has already mentioned: first, the cost sharing framework that the Allen Consulting Group put forward and proposed on behalf of the DNR, and also, second, the value of water reforms and what's the real benefit to water users, in particular irrigators.

To start with, with the cost sharing debate, if we look at where we have come from in the last 10 years, the rights and obligations to the water resource itself have become a lot more clarified, and everyone would have to agree with me, I think, that those rights have become a lot more transparent and, indeed, quite secure through the new water sharing plans. However, I think the rights to the environment still is an unclear and largely murky sort of area. I think that's where this duty of care sort of principle resides and the question of who should pay.

The National Water Initiative I think has made a good start to clarifying rights to environmental quality and environmental flows through the risk assignment framework and who picks up the costs of changes in government policy about levels of environmental flows. But I think the next step is to look at what about the impacts of the current levels of extractive use on environmental and riparian systems. That's the one that we're grappling with.

I think what the DNR submission is arguing is that we need to set a benchmark, at least to help establish some baseline levels of rights and obligations. The duty of care type principle is one which looks at the water sharing plans and says, "Well, these plans have been agreed and largely through community consultation there's been a representative and a good idea to take forward for the management of a particular valley or a region, let's use those as a benchmark level of environmental stewardship and quality that we need to aspire to", and the water users would take a share of responsibility of meeting those levels of quality.

If then, in future, the community puts on greater demands for higher levels of quality, then I think the water users have a much stronger argument to put their case and say, "Well, hang on, we have already agreed to a certain benchmark, now you're changing the parameters, we should change the cost sharing arrangements." So I think it's something that needs to be analysed in that type of framework, in a rights framework. Otherwise this debate will go on and on and on.

The second one is the value of water reform. I think a gentleman from Murrumbidgee Private Irrigators questioned whether he and his colleagues were getting a return on investment in water reform. The answer to that question is I think water reforms, the benefits from that, are still in their infancy. Through time I think the value of reform will grow. I think what is being put in place in New South Wales is world best practice in water management, and I think institutions are sometimes taken for granted. It's not until those institutions are taken away that you realise the real value in having a reliable system whereby you can trade your water, whereby you can be guaranteed of having water delivered to your door.

So I think the real value in pursuing water resource management is you do get a secure system of tradable rights and access rights and have a level of confidence with which the market can then invest in purchasing and selling those rights. So I think the value will certainly be there.

MR SUTHERLAND: I'll get Kim to address on this. Clearly, most of the costs associated with DNR's activities are related to staffing costs, and also the question that came up about the cost associated with hydrometrics services within the state. Kim Alvarez.

MR ALVAREZ: Thank you. Yes, I can confirm what Russell said before, the costing of hydrometrics stations is between about $10,000 and $14,000, with an average around $13,000 per station. That's a fully informed station, and you should note that that's not just what you see with someone standing on the banks of the river doing something, it's actually managing the station to capture the information, record the information and post the information on the net. So it's a full cost process, not just what you see out there on the dirt.

There were also some things about staffing issues. I think Gwydir Valley was thinking that there are 311 auditors in DNR. As Peter explained, water resource management is far greater than just the audit role and, as he mentioned also, it's far greater than I think what Irrigators Council were proposing it should be as just a regulator role.

Most of the 311 equivalent full -time employees are located in the regions. There are - I could be corrected, but I need to look into it - about 40 or 50 staff in head office providing those head office functions, which includes running the corporate water information databases,

running the corporate licensing system and providing across the state training, and it also includes the modelling, which is a shared resource. We haven't got enough people to put modellers in each region. They are a shared resource to provide all of the modelling for all of the systems across the state.

MR SUTHERLAND: I think it's probably best to clarify if there are any areas that we haven't touched on.

THE CHAIRMAN: If anybody feels that a question has not been answered, now is your chance. Again, I repeat what I said earlier in relation to State Water, this is not an occasion to continue a debate about something where you don't like the answer.

MR ANTHONY: Both groups tried to address this sharing of the costs to the environment. I don't think you actually got hold of what I was saying. I was saying - it came out in some last statements, the impacts of current extraction, what I was trying to say is a lot of the environmental issues are not extraction related. They are related to other practices. It seems that we don't address that. Our fear is that in your pricing - and the marshes is the one I raised - there are people down there being paid for management of marshes. I think the whole thing has to be relooked at. The irrigator shouldn't be paying for that part of it.

We want the marshes to be better. I'm just really worried that you've missed my point about it. It's not extraction creating a lot of the environmental issues, but we have to address it. There has to be a broader group of people or the community has to pay for it. That's the issue I was trying to raise.

MR SUTHERLAND: I understand exactly the point you are making. A thing that is worth reflecting on here is that there are other investments going on to address those sorts of impacts. In particular in New South Wales, jointly with the Commonwealth, there is investment of over $400m in our regional CMAs to address land and water degradation issues and to retain the balance in terms of sustainability. Many of those issues impact on improvements in water quality, et cetera.

In addition, governments are also investing significant dollars in recovering water for the environment. There is a $500m investment in the Living Murray, which is primarily investments in water-saving infrastructure, so that it does not impact on industry, and those investments are clearly being borne by taxpayers.

In terms of the sorts of investment going on in New South Wales, they include: $115m towards the Living Murray; $150m towards the recovery of the Snowy; $13.4m for the enhancement of the Macquarie Marshes and the Gwydir Wetlands.

Those investments of government are certainly, if you like, community service obligations or on behalf of the community and taxpayers to address, as you rightly point out, impacts that are occurring on our rivers and water systems that are not just caused by industry from extraction.

I think the government certainly recognises that extraction is not the only threat to the sustainability of our water resources and is investing significant resources that are basically from the taxpayer.

MR ALVAREZ: It is also probably worth repeating that what is in the DNR submission are not prices; they are costs. It is IPART's role to pick out from those costs which should, in fact, be borne by irrigators or water users and which should be borne by government. We clearly do not expect 100 per cent cost recovery over all of the activities that we have exposed.

I will give you one example: the National Water Initiative states that government policies should be funded by government - quite clearly. You will see in our submission that we are seeking actually only 20 per cent of the policy component. You may ask why are we doing that? The answer is we have estimated that 20 per cent of our policy work over the next three years is actually about markets and the clear beneficiaries of markets are licence holders and we are only billing licence holders.

That is just one example where, in our submission, we are not proposing prices; we are saying what our costs are. We have been asked to suggest how some of those activities should be split and we have done that at the request of IPART. But really the price that will actually flow from

this and the critical decision about what is paid for by you guys and what is paid by government will flow from the IPART process.

MR MORGAN: My question is to Martin van Bueren. The duty of care, as you have recognised, is something that concerns us all with the logic that you have followed through there. If I understand it, you are saying the water shares to irrigators are known, the water shares to the environment are not known; therefore, the duty of care lies with the irrigator. That is what you seem to be saying.

My point following on from that is: in fact, one of the major outcomes of the whole water sharing plan process was that the environment has known water as well and the environment is an identified user. Therefore, when you are looking at how you are going to share the burden, it would seem to me to be entirely equitable that the burden be shared between the environment and the user, because they are both identified as having clearly defined areas there. So I just did not see the logic of your saying, therefore, the irrigators pay the lot.

MR van BUEREN: My understanding of the situation with the water sharing plans is that quantities of water or shares of the consumptive pool have been allocated for extractive use and for non-extractive and environmental use. I think that very valuable contribution of having that water sharing framework in place does bring in some discipline to cost or, I suppose, sharing the access rights to a physical resource. But then, associated with your particular share of the water use, are a range of, I guess, impacts that need to be managed under that arrangement.

Putting aside how much water is actually allocated to the environment, nevertheless, you are still extracting some water for use for irrigation and there will be an ongoing set of impacts associated with that use. So the question is: how do you run the day-to-day management of those impacts? Depending on which side of the fence you stand as to who you believe holds the rights to fix up those impacts depends on how the costs are shared out. We have just put one view on the table, I guess, as to where that should lie.

MR SUTHERLAND: If I could just add to that, I think we need to be careful about the language of the environment being a user. The river is there. The water resources are there. The framework that we have in terms of our legislation is about protecting the sustainability of that resource for the benefits of all users.

I do not think it is appropriate to talk about the environment as another user that will pay its way in terms of water resource management costs. The water resource management costs arise because we have other users of our rivers and water supply systems in the interests of social and economic objectives, which we need to ensure do not impact on the sustainability of resource so those users can continue to enjoy access, and so that those users themselves are protected from inappropriate behaviour that is not consistent with their property rights or the rules.

I do not think the duty of care issue should be taken too far. It is really an expression of the fact that the department has got, as part of its regulatory role, an important part to play in protecting users, particularly irrigators, in terms of what now are very considerable assets associated with their rights to water, and going beyond that, to protecting the sustainability of a resource.

If the environment actually purchases water or there is additional adaptive environmental water created through a licensing system, then those licences will attract the same charges as any other licence. Where the environment has a specific licence that is tradable on the market, in those circumstances, the environment, or whoever is the agent for the environment - in that case in terms of environmental water - would pay the charges that would apply to any other licence. But in terms of the rules-based water in the water sharing plans, that is not a user; that is there to protect the sustainability of the resource and the environmental assets.

MR HECKENDORF: I reiterate the question I asked before about cross-subsidisation. In the past, as Tony Wright alluded to this morning, there has been cross-subsidisation between river valleys. I would imagine the two southern valleys, the Murrumbidgee and the Murray, is where the money has come from and it has gone to other parts of the system. Is there any way that we can track that money and get it back?

The other part of the question was is that under previous IPART determinations, the government had a share to put in and, as I understand it, a significant amount of that money has not been put in.

MR ALVAREZ: Rel, I presume you are talking about the river operations account in the past.

MR HECKENDORF: Yes.

MR ALVAREZ: Through the drought of 1994-1995, it might have been, yes; there were significant cross-subsidies of that account to the northern valleys. My understanding was that it was repaid in subsequent years and the accounts were back to par.

I could be taken to account on this one. You have caught me a little bit off left field in this one, but my understanding is that those accounts have been reconciled and the money still remains within the valley accounts for the specific valleys from which it was collected. That only happened, of course, up to 1996-1997 when the Pricing Tribunal's process began.

MR SUTHERLAND: The only other comment we could make is that I do not think it is really productive to talk about sort of retrospective adjustments here as a result of previous IPART determinations, unless IPART has a view about that. Certainly, in terms of this submission, we do not have any particular view about cross-subsidisation. What we are proposing is clearly the actual costs of delivery and the costs of actually providing the water resource management services and it will be a matter for IPART.

As to past subsidisation, I am not challenging your thesis that there has been cross-subsidisation. I am not entering that debate, but I think those costs probably would need to be looked at as sunk costs. But the other issue, obviously, is that we still have not got to a point of full cost recovery.

THE CHAIRMAN: Unless there are any other questions that has not been properly answered --

MR THOMSON: We do not want to live in the past, you are absolutely right, but I can remember back in the mid-90s, at some stage, $2m disappeared out of the operations account at Murray and we never saw it again. It was gone. I have no idea where it went, whether it was used for cross-subsidisation, whether it came to Sydney or where it went - I just know it totally disappeared.

CONCLUDING REMARKS

THE CHAIRMAN: I would like to wind up the proceedings now. I would like to thank everybody for their participation today. It certainly helped the Tribunal to get a better understanding of the many and varied concerns. I would particularly like to thank Sydney Water Corporation --

MR IMMARAJ: We'll take them over one day.

THE CHAIRMAN: I would like to thank State Water and the Department of Natural Resources. Clearly a lot of work has gone into the submissions. I suspect we will have further questions. We will want to probe the information and indeed extract more information, but I am conscious of where we were only some months ago when we decided to abort the attempt to do a multi-year price path and do a quick job - I won't say a dirty job, but a quick job - for the current financial year, and a lot of work has gone in since then. I really thank you for that.

It is clearly premature for the Tribunal to be forming any views at this stage. This is only the first of a number of conversations. We do not have our consultants' reports yet, but it may be helpful if I just outline where we go from here. Let me first say that a point of concern is that, from what I have heard today, we haven't got all the submissions. In fact, Bega has foreshadowed another one, and the lady down the back is foreshadowing a submission.

Can I say that we want the submissions, but strictly the time for submissions closed a week ago. We want the submissions and we will certainly extend it a little, but you need to appreciate the process is rolling on and our ability to take account of the submissions will run out very shortly unless we get them very quickly.

Realistically, to get full value from our regional visits we need to be across all the specific submissions from particular valleys, and so on, before we embark on those visits. It will not be long before we get into the period of Christmas and early January where you just can't get the staff because they are on holidays, and so on. We do need to get those submissions very quickly.

I think an important point to emphasise is that in a very real sense the reason for IPART's existence is to probe the efficiency of the utilities - in this case the department - because they are not facing competition. So it is essentially an independent regulator being put in place to probe their efficiency and make sure their costs are the minimum costs consistent with meeting service standards as set out in the licences, and so on. That is why we are here and that is a task that we certainly have some experience with.

I am sure there are people who say we have not got it right in the past, but I think it has generally been accepted that we do as good a job as can be done. There will be different views as to whether we got it right, but I don't think anyone has ever attacked the integrity of the process. We will be probing, as we always do, the efficiency of the proposals that have come before us. Can I add that where there are very big increases in particular valleys or particular services, that does act as a flag to us as to where to start probing. So the bigger the increase proposed, the deeper we probe.

Beyond that there are a number of very difficult issues I think for this inquiry, and I will attempt to be comprehensive in flagging them for you. It may help you to know where we are coming from. One of the difficult issues is the asset base grab and the size of that.

At this stage I think I should say that we have an open mind on whether we should move to a building block approach at all or whether we stay with the annuity approach that has been used in the past. I think we are mindful of the advantages of moving to a building block approach, and State Water is absolutely right, that is what we use with other utilities, including utilities like Sydney Water, so there is a prima facie case for that.

It would represent a change and we have to consider carefully the implications of the change. I mean, if we were starting with a clean sheet of paper, it might be easier to sign onto a RAB based approach, a building block approach. The fact is we are not starting with a clean sheet of paper, we have been working with an annuity based approach. So we do need to think about that.

I have noted how many times the department and State

Water had a difficult question, they'd say "That will be something that IPART can work out", like the apportionment of costs of risks, and so forth. I flag, they are very difficult questions for us. Inevitably there is an element of judgment involved.

Perhaps finally there have been a number of particular concerns raised today which affect individual valleys, or one or two valleys but not the totality - things like the Murray Darling Basin costs, bulk water discounts and whether there are commensurate services which the corporate bodies provide.

I think one that I found fascinating, when listening to the discussion, was whether the ratio of fixed to variable costs, which is moving in favour of increasing the proportion of usage charges - and in a real world that is not properly cost reflective and it does increase the risks to the water supplier, State Water - should be held uniform across all valleys or should be adjusted to particular valleys, I guess the South Coast, North Coast, Hunter. They are going to be difficult questions which we have picked up today and we will be thinking further about.

Again I would like to thank you all for your attendance and we look forward to meeting you again in the three regional centres.

MR THOMSON: I thank the Tribunal. It has been an excellent day. Everybody has had an opportunity to put their cases forward before the Tribunal and every attempt has been made to answer those questions. I thank you for that, Chairman.

THE CHAIRMAN: Thank you.

AT 3.40PM THE TRIBUNAL ADJOURNED ACCORDINGLY